DOCUMENT RESUME

ED 315 470 UD 027 227

AUTHOR Clay, Phillip L.
TITLE At Risk of Loss: The Endangered Future of Low-Income Rental Housing Resources. Third Printing.
INSTITUTION Massachusetts Inst. of Tech., Cambridge.
SPONS AGENCY Neighborhood Reinvestment Corp., Washington, DC.
PUB DATE Oct 87
NOTE 58p.
PUB TYPE Reports - Evaluative/Feasibility (142) -- Statistical Data (110)

EDRS PRICE MF01/PC03 Plus Postage.
DESCRIPTORS Census Figures; *Federal Aid; Futures (of Society); *Housing Deficiencies; *Housing Needs; Local Government; *Low Income Groups; *Low Rent Housing; Poverty; Public Housing; Real Estate; State Aid; *Trend Analysis; Urban Areas
IDENTIFIERS Department of Housing and Urban Development; Tax Reform Act 1986

ABSTRACT

This report explores the dimensions of the potential loss of low-rent housing, its causes, and the possible solutions. Chapter 1 is an introduction. Chapter 2, "Housing the Poor: Trends and Issues," includes the following sections: (1) "Trends in the Incidence of Poverty"; and (2) "Trends in Low Rent Housing." Chapter 3, "The HUD Assisted Inventory and the Potential for Loss," includes the following sections: (1) "Property Disposition"; (2) "Expiration on Use Restriction"; (3) "Transfer of Physical Assets"; and (4) "Potential Loss of Public Housing Units." Chapter 4, "Potential Losses in the Nonsubsidized Stock," includes the following sections: (1) "The Changing Environment for Real Estate Finance"; (2) "New Realities in Real Estate Investment"; and (3) "Tax Reform Act of 1986." Chapter 5, "Decision-Making and Housing Loss: Alternative Scenarios," discusses issues faced by four types of properties, as follows: (1) "Case #1: Older Projects in Good Condition"; (2) "Case #2: Older Projects in Inner City Areas"; (3) "Case #3: Newer Projects in Appreciating Markets"; and (4) "Case #4: Private Unsubsidized Low Rent Housing Analysis." Finally, Chapter 6, "Policy Recommendations," offers action suggestions for each of the major players in the system under the following headings: (1) "The Role of the Federal Government"; (2) "The Role of State and Local Government"; (3) "The Role Community-Based Housing Organizations"; (4) "Roles for the Neighborhood Reinvestment Corporation"; and (5) "Conclusions." Seven figures and seven tables are included. The following articles comprise the appendixes: (1) "Major Relevant Multifamily Housing Programs"; (2) "Mutual Housing: A Description of the Model"; (3) "Low Income Housing Tax Credit"; and (4) "Selected Cases in the Public Housing Demonstration Program." (JS)

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At Risk of Loss: The Endangered Future of Low-Income Rental Housing Resources

by

Phillip L. Clay

Massachusetts Institute of Technology
Cambridge, Massachusetts

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At Risk of Loss: The Endangered Future of Low-Income Rental Housing Resources

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Phillip L. Clay

Massachusetts Institute of Technology
Cambridge, Massachusetts

May 1987

Neighborhood Reinvestment Corporation
Washington, D.C.

Third Printing October 1987

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Neighborhood Reinvestment Corporation
1325 G Street N.W.
Washington, D.C. 20005
(202) 376-2400

Foreword

The Neighborhood Reinvestment Corporation's mission is the revitalization of lower-income neighborhoods which have experienced deterioration and disinvestment. As a result of Neighborhood Reinvestment's work, 52 neighborhoods previously in this condition are now healthy and substantially self-reliant; and 239 other neighborhoods in 137 cities, towns and rural communities are on the road to self-reliance.

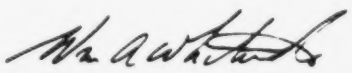
The Corporation commissioned this study because of a concern that as the supply of housing affordable to lower-income households dwindles, those neighborhoods and the homes of hundreds of thousands of lower-income families are placed in jeopardy. Indeed, in many areas the problem has already reached crisis proportions.

We have endeavored in this study to present a strong statistical picture about the rental housing units at risk. This has been a difficult task. No one knows exactly how many low-cost rental units – privately owned (with and without federal assistance) or publicly owned – will continue to be available to low-and moderate-income families. Projections are made based upon the best data available and known trends. Our best judgement is that the impact of the new tax law on lower-income rental housing will far exceed the numerical projections presented. Our hope is that changes in policy at the local, state and federal levels will ameliorate the impact.

While "housing units" are convenient for counting's sake, each "unit" represents someone's home, however modest. Each loss from the lower-income stock has its cost in government and social service dollars, certainly, but also in the lives of families and entire communities. Displacement is a growing reality in many areas, and we are reminded every day that "houseless" also means "homeless." What we do as professionals, as volunteers or as governments to preserve and produce housing affordable to lower- income households in the next few years will dramatically affect all of our neighborhoods well into the next century.

Early in Professor Clay's investigations, it became clear that much of the nation's multi-billion-dollar investment in low- and moderate-income housing only bought use of the units for the intended beneficiaries for fifteen years or so. What we should learn from this is that new systems are needed that focus on housing as a *permanent* resource.

Though not the only option referred to in the study, a network of nonprofit Mutual Housing Associations would go a long way toward providing such a system. Mutual Housing Associations, one of which is operating in Baltimore, Maryland, are ongoing producers and operators of housing affordable to lower-income families. In Western Europe, similar associations have housed families across generations, not simply for the life of a subsidy contract or mortgage agreement.



Wm. A. Whiteside, Executive Director
Neighborhood Reinvestment Corporation
May 1987

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Executive Summary

Despite federal efforts that have built up a stock of public and assisted housing with a replacement value of nearly $250 billion, the supply of rental housing available and affordable to low- and moderate-income people is shrinking, even as the need for such housing expands.

By 2003, the gap between the total low-rent housing supply (subsidized and unsubsidized) and households needing such housing is projected to grow to 7.8 million units (see Figure 4.0). Based on the national average household size, this gap represents the loss of affordable housing for over 18.7 million Americans.

Problem: Converging Forces Squeeze Supply

Three principal forces are converging to produce this problem, particularly over the next two decades. The combined impact of these three forces will be a growing number of families paying a disproportionate share of their already modest incomes for housing and a steadily increasing displacement of lower-income renters, resulting in families relegated to substandard housing, doubled up with other households, or forced into outright homelessness.

Increase in Poor, Decrease in Low-Rent Housing Units.
First, during the past 10 years the percentage of the population that is poor (as defined by the Census Bureau) has grown from 12 percent to nearly 15 percent of all Americans. During the same time period, over 1 million units have been lost from the low-rent housing supply.

Overall, between 1983 and 2003, the total number of low-rent units in America is projected to fall from 12.9 million to 9.4 million, a loss of 3.5 million units or 27 percent. During the same period, the total number of households needing low-rent units is projected to increase from 11.9 million to 17.2 million, an increase of 5.3 million households or 44 percent.

Expiring Federal Contracts and Use Restrictions.
Second, expiring federal contracts and use restrictions have put at risk a substantial percentage of the 1.9 million privately owned but federally assisted low-income rental units. As many as 900,000 of these units could be conventionally refinanced and escape federal use restrictions by 1995, with the potential for further losses continuing to 2025.

Federally assisted projects which are in good locations and those in hot real estate markets can be expected to offer greater profit potentials to their owners if they are converted to condominiums or higher-rent apartments and marketed to more affluent residents.

In addition, some assisted units will fall into serious financial trouble and may have to be foreclosed and sold to new owners. Others will be abandoned as they lose their economic feasibility, introducing a blighting influence on the neighborhoods and the potential for a new generation of slums.

Tax Reform.
The third force is the Tax Reform Act of 1986. It seems clear that this Act will have a far-reaching impact on lower-income rental housing. As tax shelter income is reduced, rent increases will be necessary in order for owners of rental housing to continue to show a profit. At the same time, new production will suffer as incentives to produce new low- , moderate- , and even middle-income units disappear.

The new tax reform law is expected to significantly further increase the losses in the unsubsidized sector during the next decade.

A summary of recommendations is shown on the following page.

Recommendations

The report's principal recommendations are as follows:

Federal Government

- The federal government should continue to provide project subsidies to developments in the subsidized stock.

- The federal government should support capacity-building for nonprofit development organizations to develop housing for the poor.

- The federal government should develop incentives to discourage private owners of subsidized housing from converting to unrestricted use.

State and Local Government

- State and local government should use the power at their disposal to provide incentives, or should use sanctions to keep housing affordable.

- State and local government should use resources at their disposal to acquire, or assist others in acquiring, housing that can be preserved for permanent use by the poor.

- State and local government should use their power to regulate for health and safety in ways that will discourage the illegal disinvestment activity that is predicted in this report.

Community-based Nonprofit Organizations

- Local groups should do research and advocate for the preservation of low-income housing opportunity.
- Local groups should create umbrella groups or city or region wide groups to address issues raised in this report.
- Local groups should prepare to expand their capacity for housing development and management.

Neighborhood Reinvestment Corporation

- Neighborhood Reinvestment should continue to develop training and information programs that expand the capacity of local groups and enable them to take advantage of existing options and the legislative and regulatory shifts that might be forthcoming.

- Neighborhood Reinvestment should continue seeking support to further test the "Mutual Housing Association" model, especially its potential for use with existing multifamily housing. Following the basic partnership approach, the Neighborhood Reinvestment Corporation should seek over a 5 year period to establish the skeleton of a national network.

- Neighborhood Reinvestment should consult with HUD and the federal financial regulatory agencies on possible roles it can play in working out partnership solutions to developments that might otherwise be lost to the affordable stock.

Chapter 1
Introduction

In the last fifty years, the federal government has invested billions of dollars in the creation of more than 4 million housing units to meet the need of families whose income is too low to afford the cost of housing in the private market. (Note: As used throughout this report, *moderate income* refers to households which earn less than 80 percent of the median income in their area. For *low income* or *poor*, we refer to those who are less than half the median income. *Affordable* housing, therefore, refers to housing these households can obtain for 30% of their income.) With small and recent exceptions, such as the Section 8 Certificate Program and the voucher program, subsidies for the production of housing units have been the principal means by which the nation fulfilled the promise of the 1949 Housing Act: to "every American family" the opportunity for "decent housing in a suitable neighborhood." While economic stimulus and support of the construction industry were important and sometimes the most important goals, a generation of programs has been crucial in helping millions acquire affordable shelter.

The stock of housing in place would cost more than a quarter of a trillion dollars to replace for the target population that continues to grow. Yet, we face for the rest of this century and into the next, the possibility of losing a majority of these units in an economic and financial environment in which this housing would not be replaced either by public action or by the private market.

This report explores the dimensions of this potential loss, its causes, and the possible solutions. It asks and then answers a variety of questions. Does the potential loss change the balance between "haves" and "have nots" with respect to housing, or does this represent a simple market adjustment where the poor might be no worse off and perhaps even better off?

The conclusions that we document in this report underscore the point that the loss results in part from a federal policy thrust that forces housing squarely into the private market. The crisis is compounded by the fact that this is occurring when it is still widely accepted that the private market cannot, without assistance, meet the needs of the poor. The coming losses represent the result of the first innings of play in a new ball game in which the poor will be worse off and when their condition will not be mitigated.

Does the potential loss that we explore come from a change in the rules and a breaking of commitments that undermine the established roles of the public and private sectors with respect to housing, or does it reflect simply the natural consequences of industry and policy processes? There is some evidence of both. The present federal administration is committed to changing the direction of federal housing policy. This change is based on a conservative ideology. It is also true that the crisis in subsidized housing is serious because long established contracts are coming to maturity according to established rules and contracts and not the actions of current officials. While the Congress has not authorized new programs to support additional housing, neither has it given the signal to abandon the existing subsidized inventory. Quite the contrary; the signal from Congress is that the national interest rests in preserving the stock of assisted housing and extending its use by the poor.[1] While tax reform suggests that there is no longer support for deep subsidy as the means of subsidizing new construction, it does not give the signal to abandon the core commitment to conserve the existing inventory.

This report also explores whether the shifts in the responsibility for housing places too much of a burden on nonprofit housing organizations and local governments. Up to this point, these agencies have had only to piggyback on federal efforts or to address issues that are particular to their communities.

We conclude that while there are many exceptions, this burden is large and that most community

based groups and local government do not have the resources to take on this challenge based on their own resources. Moreover, most of them do not have the experience or capacity to figure out the problems of complicated financing, redevelopment project management, or property management. While these local organizations have the untapped potential for an expanded role to which they may eventually be adequate, the task of being steward of the nation's housing resources is devolving on to them faster than their capacity grows.

Finally, we ask what it takes to patch together a set of solutions that match the coming problem? We make some suggestions in this regard and point to the interconnectedness of the roles of the major players. A major theme here is the need to strengthen and deepen the capacity of various players to take on a challenge for which they may not be prepared presently but for which they should prepare.

These questions are pursued in the next several chapters. Chapter 3 looks at the loss potential in various parts of the federal program inventory – from disposition of the inventory of projects in the federal portfolio, to expiration of use restrictions and contracts, to the sale of public housing units. Chapter 4 explores trends in the non-subsidized stock to estimate the importance of changes in the tax law, changes in finance and other factors that shape investment and reinvestment. Chapter 5 explores decision-making related to different sponsor/investor situations and estimates how investors, tenants and local government might view their options. Chapter 6 presents annotated recommendations for what the major players can do.

The circumstances outlined in this report underscore a sense of urgency about the risk of housing loss. It takes at least 2-3 years to put together and execute complex real estate deals. We have yet to create the mechanisms by which deals to save the assisted stock can be put together. Unless we act soon, we face losses starting in 1988 which we are now ill-equipped to stop. This situation will be not unlike what occurred in the 1960s, when we were removing low rent units, and building too few new ones, while real estate operators proceeded to *milk* properties and to turn transitional communities into crisis ghettoes.

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1. See P. L. No. 95-557, Sec. 203, 92 Stat. 2088, codified at 12 U.S.C., 1710z-11.

Chapter 2

Housing the Poor: Trends and Issues

In exploring issues related to the loss or potential loss of housing, it is important to look at the trends affecting the population for which assisted housing was developed and the changes that have occurred in the overall supply of affordable housing for this population. Is the number of households increasing or decreasing? Is the supply of units affordable to these households increasing or decreasing? These are the two questions we explore in this chapter.

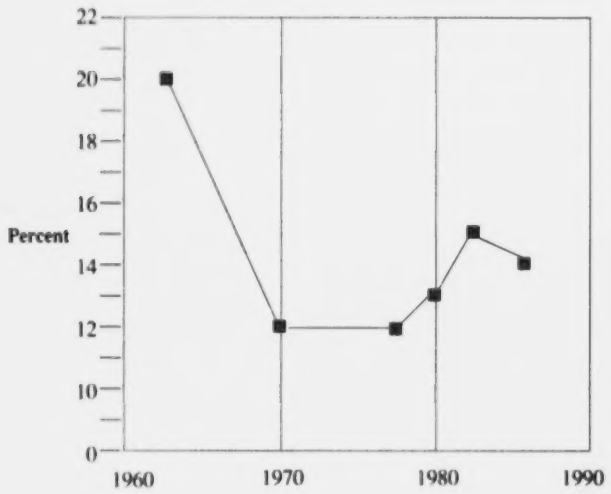
Trends in the Incidence of Poverty

Recent years have been marked by a significant increase in the number of households in or near poverty. There was a major reduction in the proportion of the population that is poor – from almost 20 percent in 1965, when President Johnson declared the "War on Poverty" in 1965 to 12 percent a decade and a half later (See Figure 2.1). However, during the 1980s the poverty rate has increased and hung stubbornly near 15%.

Not only has the number of poor, and their fraction of the total population, increased, but the composition of this group has changed. Whereas in the 1960s the poor included a large number of intact families and elderly persons, most of the current poor families consist of single parents and their children. Whereas in the past the poor population included many who are poor only briefly as a result of some special misfortune, the present poor population seems increasingly permanent.

These changes in the composition of the poor population have a major implication for the way we look at the assisted stock of housing. The new composition means, for example, that the public housing population and the population of assisted housing do not turn over as families move out of poverty status. Turnover is small and waiting lists

FIGURE 2.1
Percent of the U.S. Population in Poverty: 1963-1985



Source: U.S. Census and Selected BLS series, 1964-1986

are so long that they offer little encouragement to waiting families. In a survey of housing authorities in twelve large cities, authorities reported without exception that the waiting list was larger than their entire inventory.[1] While there are no aggregate data, anecdotal data suggest there also are long waiting lists for some assisted housing developments.

The more desperate condition of the new poor also means that rent revenues generated by assisted housing will not increase significantly. This income may even decrease in real terms if poor become more concentrated in these units. The subsidies that have been so important in the past are still needed, and for some projects an injection of funds such as that provided to bailout assisted projects in the late 1970s may be required again. This conclusion will be especially significant if there are major cost increases in any factors in the operation of these projects or if construction or maintenance problems emerge. In short, there is no way that the assisted

population can carry the full financial weight of the housing they occupy.

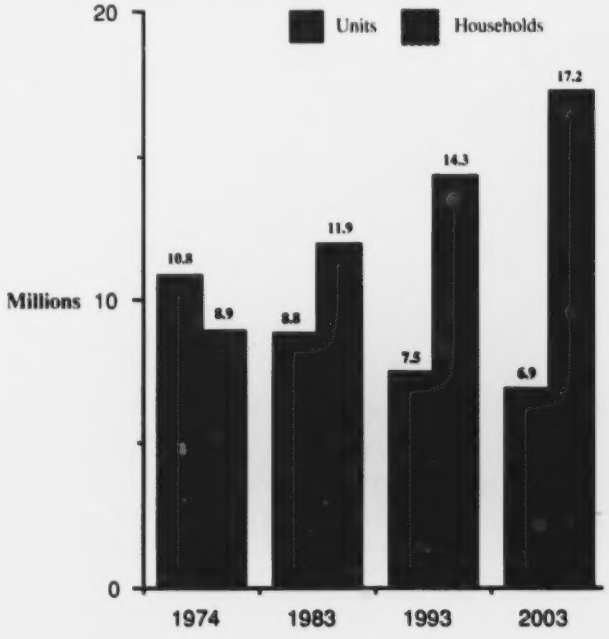
The 1970s and 1980s have been marked by an increasing crisis of affordability. A level of effort (15-20% of income) that used to be adequate to procure housing is no longer sufficient. Federal programs claim 30 percent of income as the amount a family must contribute in its housing. Of families earning less than $7000 per year, 78% already spend more than 35% for rent. For those with an income of $7000-$10,000, 59% do; and, for those who earn $10,000-$15,000, 36% pay this onerous amount for rent.[2]

Affordability is not the only problem that the poor face. More than half of the families that received a Section 8 Certificate to subsidize their rents in the private market could not find units – sometimes because of market shortages, but more often because of discrimination. More than three quarters of black families and large families faced this difficulty.[3]

It is clear that the poor need the assisted housing. Indeed, we need additional assistance so that a larger number of needy households receive adequate housing.

FIGURE 2.2

Unsubsidized Low Rent Housing Units and Households Requiring Such Units, 1974 and 1983 (actual), and 1993 and 2003 (projected)(in millions)



Note: Projection of units and households based on continuation of 1974-1983 trends.

Source: U.S. Census and Department of Housing and Urban Development, Annual Housing Survey, 1974 and 1983.

Trends in Low Rent Housing

Potential losses to the stock of affordable housing should be considered in the context of trends in the entire inventory, not just that which is assisted and subject to public policy. Indeed, housing losses are more serious when we consider trends in the stock of unsubsidized, private, low rent housing. What are the trends in that area? In Figure 2.2 in 1974, there were almost 11 million rental units with rents of $250/month or less. (The population needing such housing numbered almost 9 million.) In 1983 the number of households in need of an apartment renting for $250 (in 1974 dollars) increased to about 12 million, while the number of units with such rents decreased to nearly 9 million. We went from a situation of near balance between total affordable units and the number of households that needed them to the present and projected shortage of affordable units (see also Figure 4.0 in Chapter 4). While we added a total of 20 million units (gross) during the decade, only the 1 million (mostly Section 8 units) assisted units were affordable. (The net number may be negative since we lost units during this period and most of these were low rent units.)[4]

Those who got assisted units needed them. Table 2.1 shows the income of tenants in various types of assisted units in 1983. In all cases, the average income was near or below the poverty level and, in the case of public housing, was just over 50% of the poverty level income of $10,000 per

TABLE 2.1
HOUSEHOLD INCOMES IN HUD RENTAL PROGRAMS, 1983 (dollars)

	Annual Income (dollars)	Percent of National Median Income (percent)
Public Housing	5360	24
Sec. 8 Existing	5826	26
Sec. 8 New Construction	6477	29
Sec. 236	9456	43

Source: CLPHA, *Public Housing Today*, 1986, p. 11.

TABLE 2.2
SUBSIDY COST PER YEAR PER UNIT OF MAJOR HUD PROGRAMS, 1984

Section 236/Below Market Interest Rate (BMIR)	$1173*
Public Housing	2631
Sec. 8 Existing/Vouchers	2640
Sec. 8 New Construction	4626

Source: *HUD Statistical Data*, Selected Tables, 1985

*This figure understates somewhat the actual subsidy. An estimated 70 percent of the units receive one or more other forms of assistance. In addition, tax benefits applied, but are not reflected here.

year for a family of four. More significantly, these incomes are much below the national median income – from 24 to 43 percent.

A considerable amount has been invested in producing the assisted housing stock. There is also an ongoing cost of maintaining that resource. The cost of providing assistance to the poor varies considerably by program. Table 2.2 illustrates the yearly subsidy cost (1984) of major HUD programs. By contrast, public housing and the older housing programs are much less expensive to subsidize compared to the cost of the newer Section 8 program. The data underscore the value of the existing programs. More than $130 billion has been invested in building the units, and marginal additions to the inventory cost considerably more to build and maintain. In addition, given the changes in the tax law and the investment climate, considerably more costly and deeper subsidies to tenants or investors would be required to restart a public commitment.

The poor who were not lucky enough to get one of the assisted units competed for a shrinking pool of unassisted low cost units. In this game of "musical chairs", some households became homeless. Concurrent trends – gentrification, condo conversion, increase in one-person households, etc.– account for additional pressure on the rental stock, and explain why the market could not supply rental units to the obviously available demand, increasing the bad luck that poor renters suffered.

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1. For additional information on the present status of public housing, see generally Council of Large Public Housing Authorities(CLPHA), *Public Housing Today* (Washington: CLPHA, 1986.)

2. For additional information on trends in the poverty population, see NAHB *Low and Moderate Income Housing: Progress, Problems, and Prospects* (Washington: NAHB, 1986), Chapter 2.

3. See CLPHA, p. 9.

4. For a discussion of these trends in the supply of low cost rental housing based on analysis of data from the American Housing Survey, see NAHB, p.15-16.

Chapter 3

The Assisted Inventory and the Potential for Loss

Federally assisted housing units constitute a valuable resource for the nation's low and moderate income families. There are presently more than 4 million federally assisted rental housing units. (See Table 3.1) Approximately 1 in 5 eligible households is served by this resource, which has a replacement value of $250 billion or more if we relied entirely on new construction.

These units cover the gamut in terms of quality, type and location. They are, however, concentrated in larger cities and older communities. Table 3.1 provides a listing of the number of units by program. While public housing is the largest single component of the stock of assisted housing built in the last fifty years, most of the units, and nearly all of those constructed in the last 20 years, were produced by other programs. Though publicly-assisted, they are owned and managed by their private and nonprofit owners.

In this chapter, we look at several sources of potential loss that have their origin in specific processes or in the nature of the program under which the housing was developed. The types of loss in the stock are defined below and analyzed in the remainder of the chapter.

1. ***Property Disposition*** - This source of loss is possible because of the way HUD handles financially troubled projects held in its inventory. Three percent of the HUD insured units in 1985 had been acquired and were subject to disposition. The percent has gradually declined from earlier higher fractions. The question is whether these units are disposed of in a manner that assures their future viability and benefit to the poor, or whether disposition merely extends the troubled status of the project.

2. ***Expiration of Use Restrictions*** - Contracts for subsidized projects built under the Below Market Interest Rate (BMIR), 221(d) market and Section 236 Programs required their use for low and moderate income families for a period of 20 years. After this period, owners (except nonprofit owners) may elect to prepay the mortgage balance

TABLE 3.1
ASSISTED RENTAL HOUSING UNITS, BY PROGRAM (FY 1985)

PROGRAM	UNITS
Section 8	
New	638,000
Sub. Rehabilitation	119,000
Mod. Rehabilitation	61,000
Loan Management	208,000
Conversions (from other programs)	159,000
Property Disposition	28,000
Section 236 (excluding Sec 8)	338,000
Section 515 (excluding Section 8)	278,000
Section 221(d)(3) BMIR (excluding Section 8)	72,000
Rent Supplement	27,000
Total Privately Owned Subsidized Housing (AT RISK)	**1,928,000**
Section 8	
Existing	786,000
Voucher	11,000
Public Housing	1,352,000
TOTAL	4,077,000

NOTE: These numbers are tabulated from various documents to reflect present, not original, subsidy programs. "Existing" units are not part of a HUD production program but privately constructed housing under contract with the Section 8 program. This table includes units that are subsidized but are not federally insured.

Source: NAHB, *Low and Moderate Income Housing: Progress, Problems and Prospects*, p. 67.

and not be restricted in the use of their property. The questions for the projects reaching this milestone are whether the owner will elect to prepay the mortgage and change the use and if so, what happens to the families that have counted on the more than 350,000 housing units involved?

3. ***Expiring Contracts*** - Section 8, Loan Management and Setaside projects have contracts that run 15 years with two 5 year renewals at the election of the owners. Between 1988 and 2000, 288,000 Section 8 Loan Management and Setaside units will have their restrictions expire. Other Section 8 units have 20 year agreements that run to 2005. Between 1995 and 2005, roughly 750,000 Section 8 New Construction and substantial rehab units will have their restrictions or contracts lapse. The questions here are whether owners will elect not to renew contracts, and what will happen when projects have their contracts expire but still need subsidies.

4. ***Transfer of Physical Assets (TPA)***- For a variety of reasons, subsidized developments are sold or transferred to new owners. HUD has an opportunity to approve such transfers. Sometimes other players, such as local government or state finance agencies, have a role to play. The questions are whether, and under what circumstances, such transfers take place; how to assure that transfers do not build into them the seeds of future displacement for low and moderate income tenants on the one hand and; on the other hand, how to strengthen the long-term project viability. (Note: Transferred projects are also subject to expiring use restrictions.)

5. ***Loss of Public Housing Units*** - The federal government currently sponsors a demonstration to test feasibility of homeownership for the poor. While less than 2000 units are involved in the demonstration, success will almost certainly stimulate further loss – both in larger cities and in small communities. Public housing units are also lost in the redevelopment process where mergers and demolition reduce units. A few projects have been abolished and some "troubled authorities" have "moth balled" units.

Property Disposition

Disposition is an issue related mainly to the older stock of HUD housing. While the HUD disposition refers to both federally insured *and* federally subsidized housing, our focus here is on the older federally subsidized projects, mainly 221(d)3, BMIR and Section 236 projects.

A significant portion of this stock has had a troubled life. By 1975, 15 percent of units on line at that time had some degree of financial distress. About a quarter of these distressed units have been disposed of by HUD over the years.[1] Table 3.2 provides a summary of the current status and disposition activity in the subsidized inventory through 1984. As the data in the tables indicate, most of the units (82%) were sold with some form of subsidy and continue to be occupied by low and moderate income families. The HUD acquired inventory has diminished over the years.

More current data are not available, but estimates suggests that HUD holds mortgages on about 10 percent of its subsidized projects and has acquired (that is, is in possession of and must dispose of) about 3 percent of its inventory. About half of these units are in central cities.[2]

The question for us is whether the process by which these projects – those where HUD holds the mortgages (while the owner is still in possession and meeting payments), and those where HUD acquires the project – are being handled in a manner that assures that the low and moderate income use is preserved, and the project is financially and physically sound. The risk is in the projects HUD actually acquires, since these typically become victims of an extended period of neglect. The debate on disposition centers on implementation of the most recent property disposition statutes enacted by the Congress in 1978 (P.L. No. 95-557, Sec 203, 92 Stat. 2088, codified at 12 U.S.C. , 1710z-11).

TABLE 3.2
CURRENT STATUS OF INSURED SUBSIDIZED MULTIFAMILY INVENTORY: 9/30/84

	Insurance Ever Written[1]					
	All Projects		Non Profit		Profit-Motivated	
	Projects	Units	Projects	Units	Projects	Units
Sec.236	4,240	464,483	1,067	125,048	3,173	339,435
Sec.221d3 BMIR	1,590	191,120	409	52,835	1,181	138,285
Rent Supp.	467	32,635	187	14,331	180	18,304
Total	6,297	688,238	1,663	192,214	4,634	496,024
Percent	100.0	100.0	26.4	27.9	73.6	72.1
	Insurance Still In Force[1]					
Sec. 236	3,431	383,804	722	92,772	2,709	291,032
Sec.221d3 BMIR	942	113,493	160	21,985	782	91,508
Rent Supp.	300	20,551	103	7,927	197	12,624
Total	4,673	517,848	985	122,684	3,688	395,164
Percent	74.2	75.2	59.2	63.8	79.2	79.7
	HUD-Held[2]					
Sec.236	369	42,742				
Sec.221d3 BMIR	179	28,883				
Rent Supp.	116	9,005				
Total	664	80,630				
Percent	10.5	11.7				
	HUD-Owned[3]					
All	63	6,995				
Percent	1.0	1.0				
	HUD-Sold[3]					
All	785	62,147				
Percent	12.5	9.0				
	Unknown					
All	112	20,618				
Percent	1.8	3.0				

SOURCE:

1. HUD Housing Information Systems Division (FOIA request)
2. HUD Housing Information Systems Division, "Multifamily HUD-Held Inventory: Railroad Report," September 20, 1984 in Actenberg, 39.
3. Complied from HUD Office of Multi Family Management Data (approximate)

This and other federal laws make it national policy that "the principal goal of the [property disposition] program shall be to maintain the existing stock of multifamily projects as decent housing available to and affordable by low and moderate-income families."

A number of analyses by the GAO, and by congressional committees and independent investigators, suggest that the process over the years has not been positive and that some of these units are lost, or will eventually be lost, to low and moderate income use.[3] Specifically, these analyses charge that HUD waits too long to take action, so that the units sink deeper into difficulty – physical and financial; that HUD's management agents mismanage projects they acquire, leading to worsening conditions and tenant morale; that HUD sells to the high bidder and not necessarily to the most responsible offeror; that HUD disposes of properties in ways that are designed to get the most money for the insurance fund, with the result that available funds do not go to fix up the projects; and that projects are sold to investors that do not manage well (and might be predicted, based on past experience, to be poor risks for the task of meeting the goals of the disposition program). New investors who purchased projects at foreclosure sales were anxious to take advantage of tax benefits extended to these developments under tax provisions applicable at the time, and to obtain special subsidies that HUD made available under the Section 8 Program.

Critics further point out that while subsidies were provided and the poor held onto the units, three-quarters of the tenants experienced rent increases, even as the insurance fund lost money; and the stock was improved only marginally. In short, a bailout was created, the impact of which may be only temporary.

As the Section 8 contracts and use restriction expire in the coming years, project owners will be free to use the property in any way they choose. When sales or transfers can't be arranged, we will be left with hundreds of thousands of assisted units in varying physical and financial condition, in the hands of owners whose motivation has been tax oriented and who will have to make decisions to either get higher rents from nonsubsidized occupancy or, if the projects are not viable, to walk away from them as the previous generation of such owners did.

Therefore, attention has been, and is still focussed on how a disposition program is implemented. This issue is played out in the resolution of several struggles. This involves a struggle between the Administration and the Congress over the disposition process and the nature of the subsidy associated with projects that come up for review. The Administration prefers rent assistance to tenants (Vouchers and Section 8 certificates) who face displacement, while housing advocates favor project-based assistance. There is also the question of to whom the projects will be sold. HUD favors for-profit buyers (from whom it can get more money) over nonprofits who have a stronger commitment to long term low and moderate income benefit. HUD's view toward nonprofits is moderated to the extent that the particular nonprofit buyer has demonstrated capacity for development and not just interest in helping the poor. Most observers acknowledge that there are good owners and buyers who are profit oriented and not-for-profit groups who can't handle the requirements of ownership.

This debate touches on many of the issues that will recur in the report: financial versus social issues, for-profit ownership versus nonprofit ownership, the continued role of the federal government versus federal divestment, and long term and costly versus short term and low cost solutions.

Expiration of Use Restrictions

There are other older projects produced under the BMIR, 221(d)4 market, and Section 236 programs that are reaching the end of the 20 year period during which they are required to lease only to

TABLE 3.3
SECTION 236 PROPERTIES BUILT BEFORE 1975; AND SECTION 8 NEW CONSTRUCTION AND SUBSTANTIAL REHABILITATION

Expiration Year	Units	Percent of Subtotal
BMIR and Section 236		
Prior to 1986	4,697	2
1986-1990	80,147	24
1991-1995	246,861	74
SUBTOTAL	331,705	31.3
Section 8		
1995-2005	501,469	69
2006-2025	226,409	31
SUBTOTAL	727,878	68.7
GRAND TOTAL	**1,059,492**	**100.0**

Source: Data from HUD, 1986 and GAO, 1985
NOTE: Not all older units are subject to prepayment. About 28 percent are or were sponsored by not-for-profit groups and cannot prepay. The remainder are otherwise restricted; for example, by restrictions in Section 8, Rent Supplements contracts they took on, etc. The table does not include FmHA and HUD-held inventory. These total 436,000 units.

low and moderate income tenants. As the restrictions expire, the owners will be free to prepay their mortgages, rent to anyone they choose, convert the property or demolish it. Table 3.3 presents a schedule of these expiration dates. These units represent the major and immediate resources at risk of loss.

There are others – the more than 700,000 units built or substantially rehabilitated under the Section 8 program – that have 15 year contracts or 20 year restrictions that extend into the 21st century.

When all of these restrictions and contracts on both the older and newer inventory are considered, the potential volume of "at risk" housing becomes quite large. The General Accounting Office estimates a *minimum number of units* that may be in the federal inventory in 1995, compared to the present volume. This estimate, as far as a minimum is concerned, assumes that eligible owners prepay their mortgages by the end of fiscal 1995. It also assumes that in the renewal of Section 8 contracts and setasides, minimal terms are elected by the owner. Based on this assumption almost 900,000 units *could* be lost to low and moderate income use, leaving approximately 1 million subsidized units in the inventory, not including public housing.

The legal end of use restrictions and the loss to low and moderate income use are not one and the same. Not all eligible owners will prepay the mortgages or cancel contracts. There are a variety of factors which will influence whether the prepayment option is elected by the owner. These include whether owners, or those who exercise fiduciary responsibility for owners, are interested in remaining in the subsidized housing business; whether there is a chance for higher income tenants in the local market; what the underlying value of the land on which the project is sited may be; and how the return on this property compares to return on other possible investments. There are also local political considerations, especially in communities with strong tenant advocacy groups.

Because of a lack of data on the inventory and the limited prepayment experience, we have little basis for making an accurate estimate of the number of units on which the option to prepay will be exercised. The anecdotal evidence as well as a small and non-representative survey by the National Association of Home Builders suggest that the number might be substantial. Table 3.4 presents information from the NAHB survey. Owners of subsidized projects were asked what their intentions were in regard to prepayment when they have the opportunity to exercise that option. Of the 9 projects that were eligible, 6 noted their intention to exercise that option.[4] The others expected that they would need continued subsidy.

TABLE 3.4
OWNER'S PLANS AT SAMPLE ASSISTED PROJECTS

Metro Area	Program	Profit/ Nonprofit	Percent Section 8	Year Completed	Prepayment Plans	Comments
Boston	BMIR	P	67	1968	No Option (Flex. Sub.)	Needs Section 8
Boston	236	P	100	1972	No Option (Flex. Sub.)	Foreclosure w/o Section 8
Boston	236	NP	80	1972	Not Applicable	In Gentrifying Area
Chicago	BMIR	P	N/A	1969	Will Repay	Go market-rate or condo
Chicago	236	P	90	1969	May Repay	Wants tax incentive to stay low income
Chicago	236	P	N/A	1974	May Repay	Too early to tell
Chicago	236	NP	40	1975	Not applicable	Needs more Section 8
Jacksonville (FL)	(221)d(3)	P	100	1968	No Option(?)	Needs Section 8
Jacksonville (FL)	236	NP	67	1972	Not Applicable	Needs Section 8
Jacksonville (FL)	236	P Rent Supplement	100	1973	Unlikely	Need Rent Supplement and tax incentives
Jacksonville (FL)	236	P Rent Supplement	100	1973	Unlikely	Needs Section 8
Jacksonville (FL)	(221)d	NP	100	1973	Not Applicable	Needs Section 8
Los Angeles	236	P	50	1973	Will Repay	Go market rate
Los Angeles	236	P	N/A	1973	Probably Repay	Go market rate
Los Angeles	236	P	90	1974	Will Repay	Go market rate

SOURCE: NAHB, "Low and Moderate Income Housing," 1986, p.73

We might presume that the option would always be exercised when it is favorable for the owner not to have restrictions. This would especially include developments located in appreciating sub-markets within cities, in high rent cities, or in cases where the land itself is of sufficient value that the owner would want to remove restrictions in order to maximize options for other development or for the sale of the land. There may be a limited number of cases where the owner prepays, refinances, and continues to retain moderate income tenants, at least temporarily.

The National Corporation for Housing Partnerships (NCHP), the nation's largest owner of subsidized housing (30,000 units nationwide), is presently undertaking an assessment of how it will treat its projects. NCHP preliminary estimates indicate that 20 percent of its projects are certain to go to market rental. About 35 percent will not go market and will continue to need, and to take advantage of, available subsidies. The future of the remaining 45 percent will depend on local market conditions and investor trade-offs.

Decision factors reflect the balancing financial obligations to investors (first goal) and commitments to provide low rent housing (secondary goal).[5] Owners who have no such commitment may not engage in the balancing act and all potentially or even marginally profitable projects will be handled without regard to the interests of low income tenants.

For newer (Section 8) projects, the NCHP expects a similar number of projects to need continued subsidies. This underscores the importance of providing continued assistance, especially to newer projects. Unlike older ones with low mortgage balances and where modest rent increases might well generate acceptable rates of return, this is not likely to be the case in newer projects (or in older ones with serious physical problems). HUD estimates that 40 percent of pre-1975 developments have a marginal or negative cash flow already. The Section 8 projects, on the other hand, have larger mortgages that make it more difficult to maintain moderate rents even for the nonprofit owner without continued subsidy.

This analysis does not address the physical condition of the inventory. HUD sources put average needs at $500-1000 per unit per annum for replacement and deferred repair needs. These conditions obviously affect both the quality of life for the tenants and the investment decision that will be made in connection with each property. The new tax law includes provisions that will influence these decisions. These are discussed in another section of the report.

When various restrictions are removed, it is fair to assume that presently assisted units would be subject to substantial increases in rent, increases sufficient to replace the subsidy (including the no longer available tax benefits). The added rent required to replace the subsidies would range from perhaps $100 per month in a 236 or BMIR project, to more than $400 per month in Section 8 projects. This does not include an additional amount required to amortize rehabilitation or to increase return. What this illustrates is that, if the tenant had to cover the subsidies that HUD now pays, the rents in these developments would, in some cases, more than double and make the tenants who have had a fair deal for years new victims of the affordability problem.

Transfer of Physical Assets (TPA)

Since the early 1980s, the Transfer of Physical Assets (TPA) option was originally viewed by nearly everyone in the real estate industry as a good process for transferring subsidized real estate. It allows subsidized projects to be transferred to new owners without the intermediate steps of HUD foreclosure and management, though this should not be read to imply that only projects in financial difficulty have TPAs. The subsidy is transferred with the property. HUD's right to approve such transfers was supposed to insure that the interests

of the federal government and of tenants would be protected by conditions placed on the new owners, including requirements for the infusion of new capital, a stronger operating position, and enhanced management capacity.

The transfer of physical assets is assumed to have multiple benefits. In some cases HUD gets to revive a troubled project or to get rid of disinterested owners. The original owner is able to get rid of a used-up tax shelter, to obtain a cash return and sometimes, to maintain an ownership position in the new entity. From the perspective of any player, the new owner may be either better, worse, or the same.

The buyer gets a new tax shelter often accompanied by a favorable second financing arrangement and a favorable tax treatment (now repealed in the new law) that makes it an attractive investment. This new investment comes without the trouble of getting into a new project where feasibility is untested. The tenants are supposed to get a stronger project with continued subsidy.

In addition, the development supposedly gets additional capital infused though the evidence suggests that such infusion is not large – typically less than $1,000 per unit.

It is not clear how many TPAs have been made. HUD estimates 1000 TPAs (for subsidized and unsubsidized projects) by the end of 1983. More than 1100 were approved for 1984 and an unknown number of unauthorized TPAs are acknowledged by those in the real estate field.[6]

This scheme might appear to be generally favorable to all, including tenants, but there are a number of aspects of either the TPA concept or its implementation that represent risks to the continued use of the project for low income families. The first fact is that at the point at which use restrictions expire, there is still the chance that the units will be lost, and will be lost to a new owner who has taken the potential alternative use of the development into account in the financial terms of the TPA. For example, a development which is transferred from one owner to another where the use restriction expires in a relatively short period of time commands a higher price. The sales price might include an amount in a second mortgage which may be deferred, though the losses to Treasury are substantial and certain since the "soft paper" creates losses that reduces the taxes of investors. The refinancing results in a larger debt load that assures substantially higher rents when and if the project is no longer restricted. Owners cannot pass on the cost to tenants as long as use is restricted so the real problem has yet to be realized. If there is a positive outcome for tenants, it is that this process is, in the present environment, an alternative to "milking". TPAs give us 5-7 years to come up with a better, more durable solution.

For cases where market rental is unfeasible and the mortgages are not prepaid, the TPA represents a burden that the project carries into a future when the federal government or others may have to contemplate new types of subsidy. The new debt burden represents excess or "paper" costs which are legal but which do not represent, in many cases, real value. While professionals claim that this soft paper is not expected to be a problem and that no collection is intended, this may not be the case if holders of the mortgage sense that there is a source of subsidy to tap for the redemption of their paper.

Typically, the TPA has done nothing to strengthen the physical condition of the weakest projects. While HUD reports that half the TPAs increase owner contribution to repairs, in a kind of perverse outcome, most of the projects that had TPAs were not those in the worst physical condition. These were avoided.

The financial benefits generated by the transfers did not go into the projects but to buyer (tax benefits), to the seller (in the form of cash proceeds plus a second note), to lawyers and syndicators (for transaction fees,) and to HUD and local governments for mortgage and tax delinquencies.

It is important to note that the TPAs were successful in some cases in preventing foreclosure and its associated effects. These effects might have been worse than the TPA.

Potential Loss of Public Housing Units

The Public Housing Program stands as the largest single program to provide housing to low income families. As of 1986, there were 1.35 million public housing units; this is almost as many as the number of Section 8 units. The public housing program, having started in the 1930s, grew steadily through the 1960s. Development since 1970 has been mainly units for elderly and handicapped individuals, not families.[7]

While public housing units are scattered all across the country, most of the units are concentrated in a fairly small number of large housing authorities. There are more then 3200 public housing authorities, but there are only 140 authorities that have as many as 1250 units, and these 140 authorities account for more than 60% of all public housing units. New York, Boston, Chicago, Washington, Philadelphia, and Saint Louis have, by far, the largest concentration of units, even among large authorities. The authorities in these cities account for a quarter of all public housing units.

Public housing was originally intended to meet the urgent housing needs of veterans and out-of-work families during the depression and post war period. Families were expected to live in public housing until their fortunes improved, at which point they would be able to move out and take advantage of other housing opportunities in the private market, or benefit from new programs available for veterans and young families through the VA and FHA.

The transitional nature of public housing worked well until the mid–60s when large cities started to experience massive suburbanization, and when public housing was increasingly used to meet the urgent needs created by highway and urban renewal demolition and by the increasing concentration of poverty in cities. In the largest cities, minority concentration also increased. Families in public housing found it increasingly necessary to stay for longer periods of time as they had fewer choices in the private market.

Subsidized housing programs which started in the 1960s and which are addressed in other sections of this report were designed mainly to provide additional opportunities to moderate income families who had outgrown public housing, but who still were too poor to afford private unsubsidized options.

Whereas the original public housing program mainly provided shelter for the working poor, increasingly public housing has become housing for the poorest of the poor. One half of the public housing population, for example, earns less than 30% of the metropolitan median income. (National median income is almost $25,000 per year and the poverty threshold is just under $11,000.) The median public housing tenant earns less than $6,000 per year, compared to a median as high as $9,600 per year for families in HUD's other major programs.

Public housing, regardless of condition or reputation, is in high demand. A 1986 survey of the largest public housing authorities found that, in all of the authorities included in the survey, the number of families on the waiting list equaled or exceeded the total number of units available in the locality.

Money is not the only issue affecting the housing opportunities of public housing tenants. Data indicate, for example, that more than half of public housing-eligible tenants who were offered Section 8 certificates failed to find private housing on the open market. More than 70% of minority families holding certificates experienced difficulty in the private market.[8]

Public housing plays a critical and indispensable role and it plays that role even more in large cities where housing is expensive, in short supply, and unavailable to the poor and to minorities.

In 1985 HUD embarked upon a homeownership demonstration program to sell a limited number of public housing units to tenants. While the number of units in the demonstration is not large – a mere 2000 units originally, now just under 1500 – it

is expected that if the demonstration proves successful, the sale from the public housing inventory will be encouraged widely as a way to promote home ownership opportunities for the poor and to reduce the federal government's responsibility for housing.

HUD does not propose to replace with new units the rental opportunities that would be lost. Table 3.5 presents some summary information on the local programs included in the demonstration. Appendix D presents brief summaries of the various demonstration programs around the country.

There are several things suggested by this demonstration. The income of potential buyers suggests that the program is aimed at those in public housing who have the highest incomes and who could afford to carry a burden of debt that makes it possible for them to buy a discounted value house. Selling prices are typically set to reflect the capitalization of 30% of the prospective buyer's adjusted gross income.

The developments for sale have as few as ten units and as many as 250 units. While the local demonstrations are not far enough along to know how they will work, it is assumed that there will be some kind of cooperative or associative ownership in most of the larger projects. Local demonstration programs have a variety of options under consideration for how the developments will be managed and other details related to the sale of the units. To this date, few units have actually been transferred to tenants. As of July 1986, 40 of the 1472 units were sold or under contract and only 303 families have been selected.[9]

This demonstration by itself is not significant with respect to the issue of housing loss addressed in this report. Less than one-tenth of one percent of public housing units are at risk of loss from this demonstration. But the significance will be much greater if the demonstration proves successful, such that this becomes a major thrust of the federal public housing policy. Local authorities who have faced declining operating subsidies in recent years might elect to divest. Some of the more numerous small authorities that have never enjoyed strong local support may elect to divest completely, while some tenant organizations may press to take control and turn projects into cooperatives. No new family public housing is in the pipeline to replace units lost or to meet the need reflected in the growing waiting lists.

In addition to the actual loss of units from a stock that is not being replenished, there are some other concerns. For example, that the residual public housing population would be much poorer if

TABLE 3.5
CHARACTERISTICS OF PUBLIC HOUSING HOMEOWNERSHIP DEMONSTRATION

Number of Original Demonstration Sites (federal only)	18
Range in Number of Units per Development	10-242
Form of Ownership Proposed	
Fee Simple	13
Condominium	2
Cooperative	3
UnKnown	6
Range of Sale Prices	$2000-35,000
Range of Income Thresholds	$7500-35,000
Estimated Monthly Housing Expense	$175-575
Range of Down Payments	$100-3000
Range of Financing Terms	
Term:	Typically 30 years
Interest Rate:	Tax exempt rate or less
Type of Financing:	Most are tax exempt or otherwise subsidized financing,including PHA
Resale Restriction:	Almost all have some type resale restriction

Source: U.S. House of Representatives, Hearings, *Committee on Government Operations*, 1985.

those with higher income are "creamed"; that the units left would be the worst units; and that the concentration of poverty and physical neglect would be even more serious and obvious than they are now. This would further erode the already weak support for this program.

There are substantial controversies within the public housing advocacy community about the sale of units. Many public housing activists are particularly critical and have expressed great doubts that the demonstration will work. During the Congressional hearings in 1985 a number of public housing authority directors and tenant leaders expressed opposition to the demonstration and to the idea of federal divestment of this stock of housing. Boston was particularly opposed to it. St. Louis, after having first agreed to participate, later declined. Other major authorities, New York for example, elected not to participate as well. The authorities in the demonstration are, nevertheless, broadly representative of all active authorities but not of the authorities in cities where public housing is a critically important part of the low cost housing stock. (Chicago, Baltimore and Washington participated but only with very small projects – less than 40 units each – and only after some local controversy.)

The sale of units is just one way public housing units might be lost. We know that in several cities where large modernization efforts are undertaken, the result is often that the renewed project has fewer units – a result of mergers, selective demolition and other actions taken to improve the property or create large units, more open space, etc. At the extreme, Pruitt-Igoe was demolished to save the area and in Boston, Columbia Point as a public housing estate will be reduced by two-thirds in order to upgrade a now valuable site for a mixed income population.

There are no data to indicate the extent of such modifications and it is important to acknowledge that some of them are necessary to correct design or siting problems in the original construction. What is important to note is that once the bonds used to finance these developments are paid off, there is no leverage whatsoever against public housing authorities (typically independent agencies not accountable to an electorate) who might want to divest of public housing units. The paying off of housing bonds has already started and will accelerate in the years to come. In the future, housing authorities will not be required to keep the units, to sell them to tenants only, or to maintain their low income use. Those that now find themselves on valuable sites, in appreciating neighborhoods and in communities were there are no strong housing advocacy groups, are at risk for substantial disinvestment.

Those interested in providing housing to the poor can take a couple of different positions regarding this demonstration. First, they could avoid it altogether as an area in which they have no major experience and in which the dust has not settled on whether it is broadly acceptable or feasible.

The second possibility is that they could play a role in organizing tenants (in cooperatives, mutual housing associations, or partnerships) to assume responsibility for their housing that would be maintained for the poor in perpetuity. One could argue that this is a reasonable option for a set of tenants who are similar to, perhaps even poorer, than others, for advocates or neighborhood developers assisted in various homeownership promotion efforts. This would place the community group squarely in favor of such divestment and force it to respond to the charge of cooperating in the loss of units on which poor renters rely.[10] A third option for community-based groups is to work with the states. Several states are initiating programs which roughly parallel the federal program. These range from a state public housing program in Massachusetts which plans to build or acquire an additional 5000 public housing units in the next five years to inclusionary programs in California, New York, New Jersey, and other states where a fraction of units in a "market" development will be reserved for the poor. The new "tax credit" program managed by the states (Appendix C) suggests that participation in housing production will expand to even more states. Cooperative housing programs are planned in a variety of cities across the country.

Conclusion

The data and analysis in this chapter support the conclusion that the stock of federally subsidized housing is substantially at risk of loss to low and moderate income families in the remaining years in this century. While there are data problems, it appears that as many as half of the assisted units are on a course to be lost to low and moderate income use in the next decade, with additional losses by 2025. The number will be larger if subsidies scheduled to end are not extended to those projects where the owners are willing or could be convinced to accept new subsidy. The remaining projects may eventually be lost – either to disinvestment (by owners who can't or won't maintain the projects) or reinvestment (where the owner eventually gets much higher returns from up-scale market tenants or from different uses of the land). In short, this is an estimate of potential loss. The number actually lost will of course depend on market conditions, public policy, and calculation by owners of what their best interests are. The recommendations presented at the end of this report, if substantially adopted, would cut the loss estimate substantially.

When better data are available, we will be able to be more specific in this projection. For example, we will be able to estimate the impact in particular cities for types of properties and for characteristics of properties by owner type, financial and market conditions, and other characteristics.

Such analysis is likely to show that the most serious impact will be in those cities where the subsidized stock is a large fraction of the low rent stock. While nationally these units are less than 3 percent of all units, they constitute twice that proportion in cities such as Washington, Atlanta, New York, and San Francisco, Chicago, St. Louis, and other cities. In Boston, public and subsidized housing constitutes 18 percent of all units! The impact will also be larger in cities with either tight markets or high construction costs. These factors create incentives for conversion to unrestricted use.

While political pressure at the local level might moderate or delay these losses, it will take strategic planning, creative solutions (regulatory and financial) and new resources to mitigate the losses.

What is at issue is simple: permanent housing resources for the poor. The reader will appreciate that solutions are not simple. For a generation we have met the housing needs of those who cannot be housed in the market by giving incentives to developers to provide housing. We tried to create special commodities, but commodities nevertheless. What we have yet to figure out is how to create and maintain housing opportunities in perpetuity outside the commodity system. Public housing was the expensive and unpopular tool for achieving this, and it now has few supporters. Cooperative housing goes part way in this regard.

The model of "mutual housing" – widely used in Europe and only tested recently in this country – stands as an important new idea for how to provide housing to the poor in a manner that keeps it affordable, offers the chance for self-expansion, and is available to the poor indefinitely. (For a description of the Mutual Housing Association model, see Appendix B.)

1. For the best discussion of this issue, see Emily Actenberg "Subsidized Housing at Risk: The Social Costs of Private Ownership", a paper presented at the Conference on "Housing Policies in the Eighties: Choices and Outcomes", May 17-18, 1985. Also see John Moore, "Expiring Uses" *National Journal*, (August 2, 1986), 1184-1888. The best summary of congressional review is contained in U. S. House of Representatives, Committee on Government Operation, "HUD's Proposed Revisions to the Multi-family Property Disposition Regulations," February 20, 1985.

2. From interview with Laurent Hodes at HUD, December 17, 1986.

3. See note #1.

4. The reader will note that some of the sponsors gave a conditional answer. As will be clear in other sections of the report, there is every reason to believe they will exercise the option, unless presented with some strong pressure or incentive to do otherwise.

5. Based on interview with Conrad Egan. Also see, Conrad Egan, "Testimony by the National Corporation for Housing Partnerships on the Preservation and Protection of the Low and Moderate Income Multifamily Housing Inventory," prepared for the Subcommittee on Housing and Community Development of the Committee on Banking, Finance and Urban Affairs of the House of Representatives, September 23, 1986.

6. Actenberg, p.34.

7. For a comprehensive overview of the nature and status of the public housing stock see Citizens Housing and Planning Association, *A Research Report: Tenancy and Costs in Public Housing – Policies, Attitudes and Case Studies* (Boston: CHAPA, 1986. Also see Raymond Struyk *A New System for Public Housing* (Washington: The Urban Institute, 1980). Also see CLPHA *Public Housing Today*, 1986.

8. For a discussion of this, see CLPHA, p. 8.

9. See HUD Memorandum to K. Beire (HUD/PDR) from Hartley Fitts, dated July 9, 1986.

10. There appear to be safeguards to prevent displacement as demonstration guidelines require that no incumbent tenant be forced out of public housing as a result of the demonstration.

Chapter 4

Potential Losses in the Nonsubsidized Stock

Up to this point we have focussed on the potential losses in the federally subsidized stock of rental housing. While this sector is important, most moderate income renters and virtually all new households in this population live in private, unsubsidized housing where the owners are not legally restricted in the terms under which they lease their properties. The loss of housing opportunities in this area depends on the environment for investing and reinvesting in rental housing.

There are two major aspects that relate to the potential loss of rental units in the unsubsidized sector – the trends in housing finance and investment, and the tax treatment of rental housing. These two broad topics include many others: the relative attractiveness of the residential real estate investment compared to other types of investment; the viability of existing investment properties given stricter underwriting standards; and, the market response to imbalances in supply and demand.

The Changing Environment for Real Estate Finance

In recent years thrift institutions have experienced difficult times. Part of the difficulty relates to the new unregulated environment in which they operate. Part relates to economic trends that affect the performance of their assets. Starting with more than 4000 thrifts units operating in the mid 1970s, more than one quarter of these institutions have been lost already. Almost 1 in 5 (18 percent) presently experience difficulty.

These institutions have been the stalwarts in residential lending especially to small investors. Increasingly, however, mortgage banking companies and mortgage service firms have moved to take advantage of a strong national secondary market in a deregulated environment. The thrifts have had to cope with adjusting to the new environment while still saddled with portfolios of low yielding loans.

As though this were not enough, the asset issue has become more serious as the volume of "nonperforming" loans has increased, raising important questions about future directions in real estate lending. This period of reassessment injects extra stress on our confidence about the role traditional housing finance institutions play in maintaining a private rental stock affordable to the poor.

The present concern about real estate finance is important not because there is evidence of major failure in the urban portfolio. The issue is the future of investor-owned, low rent, unsubsidized rental housing where economic feasibility has always been tenuous. Now that tax benefits are reduced, the urgency of economic feasibility is even greater. Officials, residents and progressive lenders made great progress during the 1970s in building confidence in this sector with the result that many housing units on the road to deterioration by disinvestment have been revived and kept affordable. There is the need for this progress to continue and to expand.

However, new trends give negative signals to owners who want to, or who face the need to refinance, and to new investors considering acquisitions. Recent evidence suggests that there is a rapid growth in bad real estate loans. The FSLIC has more than 7 billion dollars in nonperforming loans. The increase has been rapid in the recent years and is expected to continue to grow. Only in about 20 percent of the cases is the asset foreclosed. Just under 20 percent of these loans are residential properties. The residential properties include apartment buildings, 1-4 family properties, unfinished projects, raw land, and other holdings. Since we have no unit or occupancy information, we cannot estimate the total or potential loss experience, though we have reason to believe it is large. Few losses have occurred in cities in the northeast or midwest. Most of the problem has been in the south and south central states – a consequence of

weak regional economies and depression in the oil and agriculture industries. The key point here is that the lustre and allure of real estate has faded as underwriters and regulators look with concern at the mounting problems. The psychological impact is significant because it dampens what had been a growing acceptance of modest "risk." For example, it jeopardizes deals held together by "creative financing."

While this puts the brakes on speculative projects of the type that are presently experiencing difficulty, it also puts at risk projects where a creative scheme of some sort is the only way to obtain benefit for low and moderate income households.

There are other developments that may be a negative influence on lending in the urban rental sector. With respect to savings and loan institutions, the 1986 Tax Reform reduces their ability to shelter their income with bad debt allowances. In addition, the new law reduces — from 82% to 60% — the amount of their investment they are required to make in real estate. The law greatly expands the range of real estate investments they may make. On the margin, this encourages thrifts to look for additional ways to invest in real estate other than some of the more "risky" ones that have lead to the current situation. They will look to especially sound suburban investments or invest in mortgage-backed instruments. They will no longer tie their fortunes to local, much less neighborhood, real estate markets, especially where a higher or more secure return is available in another medium or market.

Urban reinvestment and "urban lending" may be casualties in this regard because of its perceived or actual "low return-high risk" character. While recent experience does not support a broad conclusion that urban markets are "high risk," it is true that housing for the poor will, under the best circumstances, produce only a low return. This is why a major thrust of this report is that we should seek to shelter as much as possible of the housing stock already affordable from these pressures.

On balance, developments in the finance industry point to more cautious, even more conservative lending practices, though no one can say how much at this time. For example, the effect may be to reduce appraised values and force borrowers to have more equity.

Lenders may also be less sympathetic to non-profits who lack an extensive track record, or to new and "amateur" investors. They may be less interested in refinancing marginal properties and may come to view "creative financing" schemes with more suspicion.

Thrifts aren't the only lenders. Banks, mortgage companies, insurance companies and some brokerage houses are also involved in certain aspects of real estate investing and underwriting. Each of these entities has set up real estate oriented companies that tend to have specialized interests, such as construction lending, equity investments, commercial real estate, large mixed use developments, etc.

The thrifts are bellwethers for the issues of concern in this report because they are the largest source of lending for the smaller investor in existing housing, and because they have an institutional presence in local communities that sets the tone for local housing finance. The new larger role of mortgage and service companies as well as a national secondary market suggest the role for thrifts and their ability to be responsive will have to be reassessed in light of this more crowded and cautious playing field. For example the new environment means their degrees of freedom with reference to responding to "local needs" are reduced. Those who advocate for neighborhood and housing initiatives that involve lenders will have to gain the support of the secondary market institutions as well as the regulators if the initiatives are to receive a favorable reception. Advocates will also have to be sensitive to the new competitive setting in which thrifts find themselves.

New Realities in Real Estate Investment

Beyond the institutional trends mentioned above, there is the matter of investor interest. The

current perception among investors is that the only type of private rental housing that makes sense – to buy or to hold – is that which is profitable on a cash flow basis. Lenders will be looking for a cash return in their underwriting. In the present environment, they have every incentive to construe this conservatively. Investors, likewise, will look for a cash return. This is not an encouraging situation for low and moderate rent properties whose sponsors are used to selling losses. They may face a crisis of confidence from investors, potential buyers and lenders. This sagging confidence will eventually show up as a sale to a new investor and tenant upgrading, deferred maintenance or worse.

In a way this is a new casting of the urban lending problem experienced more seriously between 1965 and 1975, when urban lending on conventional terms by mainstream institutions was very limited. Urban markets have strengthened since the 1970s, so the suggestion is not that we will go back to the old pattern entirely. There is now an upscale rent/condo market in large cities. But we could go back partially.

Most affected is the stock of rental housing in which the tenants are already paying as much as they can afford and the owners have been satisfied with combining tax benefits with limited cash return. As the tax benefits decrease in the transition period between now and 1990, these owners will be faced with a rent base limited by the low income of the tenants, stable or declining values, limited refinancing options, and the possibility of further economic erosion. If tenants continue to be sheltered in such properties, it will be in housing in which the owner is disinvesting. If tenants move, they are unlikely to find better deals elsewhere.

This changing environment is a clear invitation to slumlords who have no qualms about milking property. They will take advantage of financial loopholes and non-mainstream sources of capital; they will abuse insurance companies and state and local programs; and they will outsmart local regulators. If we are no better able or more willing to deal with this type of behavior now compared to 20 years ago, these slumlords will do a lot of harm to tenants and to the housing stock before their end game is concluded.

The stock of housing at risk of these consequences is approximately 8.9 million low rent units. This is the portion of the national inventory which has already been shrinking – down from almost 11 million units a decade ago. Shrinking during the decade was due both to normal loss and to upgrading to higher income groups.

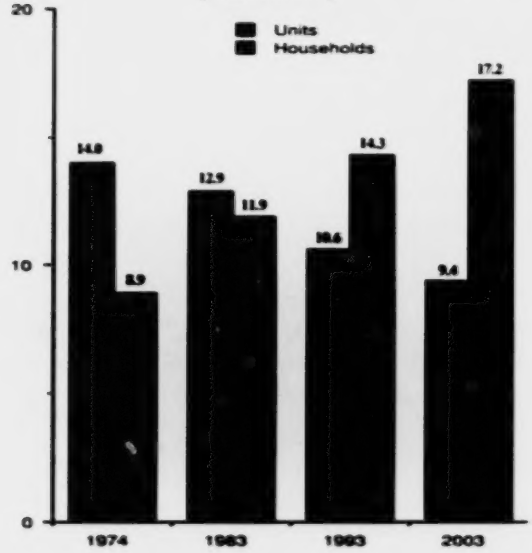
Presently, we are not adding to this stock. We noted earlier (Figure 2.2), a continuation of recent trends would reduce this stock by about 18 percent to 7.5 million units, in 1993, and by an additional 600,000 units in 2003. If our analysis of the impact of changes in the investment and tax environment is correct, the number of private low rent units in the out-years may be much smaller than projected here. Offsetting production or additions to the stock are not expected. Nonsubsidized, non-luxury rental housing is the weakest sector of national housing production. When this projected shrinkage is combined with the estimated losses in the subsidized sector and growth in the number of needy households (see Figure 4.0), the crisis is clear.

What does all of this mean for those concerned about the potential losses in this process? The Neighborhood Reinvestment Corporation and others can create or strengthen reinvestment partnerships in the 1990s as they did in 1970s and 1980s. These efforts, however, have to recognize the new reality we have summarized here. This means that relationships with the lending industry and financial regulatory agencies started by groups interested in reinvestment need to be rekindled and reassessed to take account of both changes in the capital market and the changes in the players in the real estate industry.

Tax Reform Act of 1986

The provision of both assisted and unassisted low and moderate income housing in the last several decades was possible in part because of provisions in the Internal Revenue Code designed to supple-

FIGURE 4.0
TOTAL LOW RENT HOUSING RESOURCES AND HOUSEHOLDS REQUIRING UNITS, ACTUAL AND PROJECTED, 1974-2003
(in millions)



* Low rent units equal the sum of public housing, assisted housing, and those private unsubsidized units that rent for $250 per month or less (in 1974 dollars.) Projections are based on a continuation of 1974-83 trends. Projection of the number of poor households assumes a 2 percent annual increase in the number of such households. The reader will note that in 1974 and 1983, there were more affordable units than "poor" households. Only between 2/3 and 3/4 of these low rent units are available to the poor. The rest are rented to families who are not low income. This stock is also subject to a high vacancy rate, inflated in part because some of the units are boarded up or abandoned and therefore not available for occupancy.

Source: U.S. Census and Department of Housing and Urban Development. *Annual Housing Survey, 1974 and 1983.*

ment the returns to investors who otherwise would not have found investing in housing as profitable as other investment media. Special tax provisions to aid low income housing provided a wealth of benefits beyond the traditional deductibility of mortgage interest and taxes. These included special provisions such as accelerated depreciation and lower rates on capital gains. For housing occupied by low income families, there were additional benefits. Lenders had their bad debt treated favorably from a tax point of view and construction financing and other development costs were handled in a favorable manner.

The Tax Reform Act of 1986 substantially modifies the tax aspects of housing investment and makes only limited provisions for assisting real estate, including low income housing development. Major provisions are summarized and compared in Figure 4.1. In addition to the obstacles to producing housing for the poor, the new tax law also makes it more difficult to maintain low and moderate income benefits as existing housing turns over, regardless of its subsidy status. Lower marginal tax rates and the elimination of capital gains rates, among other provisions, remove additional incentives based on tax avoidance.

In this section of the report, we will summarize the major tax change provisions, evaluate the impact of these tax changes on rental investment, and discuss what these changes mean.

The powerful impact of tax benefits on the ability to develop or manage rental housing generally and low cost rental housing in particular cannot be emphasized too strongly. The new law: 1) reduces the value of deductibility of interest and real estate tax expenses; 2) increases the depreciation period from as few as 15 years to 27.5 years; 3) capital gain preferences are repealed thus eliminating any difference between taxes paid on ordinary income and taxes paid on capital gains; 4) further restricts the ability of states to issue tax exempt bonds which, in recent years, have provided below market interest rate financing; and 5) substantially reduces the ability of limited partners to invest in real estate to obtain losses which help reduce tax liabilities resulting from other income.

This final set of provisions specifically eliminates the value of tax syndication which often generated cash (for profits or subsidy) valued at 20-25% of the total mortgage amount. For nonprofit organizations this represented the resources they could invest in a project to reduce rents further or support other development activity. For profit developers, it provided a return to supplement the often limited or negative return from the cash operation of projects.

FIGURE 4.1

Major Provisions Affecting Rental Housing
(excluding special low-income housing provisions)

	Prior Law	1986 Tax Reform Act (when fully effective)
Depreciation	19 yr., 175% Declining Balance	27.5-yr. Straight-Line
Construction Period Interest & Taxes	10yr. Amortization	Depreciation
Capital Gains	60% Exclusion (20% max. rate)	No Exclusion (28% max. rate)
Depreciation Subject to Recapture	Excess of declining balance over straight-line	not applicable (no capital gains exclusion)
Passive Loss	None	Rental loss only deductible against rental or passive income (5yr.phase-in); except $35,000 in losses allowed if active manager or $7,000 in (phased out at higher incomes)
At-Risk Exemption	Yes	Only for third-party financing
Tax Exempt Bond Financing	No volume limit limits	Low volume tighter income imits
Historic Rehab TaxCredit	25% with 1/2% basis adjustment	20% with full basis adjustment
Alternative Minimum Tax Rate	20%	21%
Housing Related Preference Items for Minimum Tax	depreciation excess of straight line Capital Gains Exclusion	depreciation in excess of 40 yr. straight-line. All "passive activity losses" during phase-in. Interest on private-purpose tax-exempt bonds. Gain deferred by installment sale.

Source: NAHB. *Homebuilding After Tax Reform: A Builder's Guide*, 1986, p12.

Figures 4.2 and 4.3 provide characteristics and a cash flow analysis of a hypothetical project under the old law and under the new law. Under the old law, with all of the tax benefits in place, returns were substantial, starting at 13% in the sample case, and declining gradually. Under the new law, the same project produces a negative return initially and a very small return afterwards.

The negative effects of the tax law are not limited to those who might consider developing new real estate projects. Even long term owners who sell will find that their returns will be substantially reduced because of the elimination of the lower capital gains tax rate. The limitations on syndication discourage the rehabilitation new or existing owners might undertake. The old law allowed rapid depreciation for rehabilitation of housing for low income occupancy, for example. The new law does not.

The inability to benefit from various "creative financing" schemes, as well as the cautious underwriting standards that the new law encourages, represent additional barriers the new law creates for existing property owners who are willing to sell and for the potential buyers of such developments.

For owners in strong markets where rents can be raised to compensate for these shortcomings, the difficulties may not be as serious (except for low income tenants, who no doubt will face significantly higher rents). But the chilling effect of the greater difficulty in refinancing, as well as the softer market for income properties that discourages new owners, present a significant threat to the maintenance of the existing stock of low income rental housing, both subsidized and unsubsidized.

Tax reform provides a definite disincentive to the purchase or rehabilitation of any property for low income use without an adequate and long term subsidy *tied to the housing*. The fact that some tenants have certificates is not sufficient since cash assistance is portable and, therefore, is not a reliable stream of income on which to base a loan.

What are the issues of tax reform for community based non- profit housing developers? There are several. The benefits that have been achieved through use of the tax law have been substantially

FIGURE 4.2
CHARACTERISTICS OF A SAMPLE PROJECT

Number of Units	100
Development Costs	$4,257,250
Structure	3,757,250
Land	500,000
Construction Period	Calendar Year 1987
Placed in Service	1/1/88
Financing: Debt	Conventional
Equity	Syndicated Equity
Interest	10.5%
Loan-to-Value	75%
Required Rate of Return	13.0%
Tax Rate of Investor	50% under prior Law 28% under Tax Act
Operating Expenses	$150 (per unit per month)
Vacancy Rate	5%
Economic Assumptions:	
Annual Increases in Operating Costs	5.0%
Annual Increases in Rents	3.5%
Annual Increases in Resale Value	3.5%
Expected Holding Period	10 years

Source: NAHB, *Homebuilding After Tax Reform: A Builder's Guide*, November 1986, p.12.

reduced, and therefore will not be the money that draws private investors to produce or maintain affordable housing. While there is a new low income housing tax credit, major benefits of the credit (a description of which is attached as Appendix C) cannot be used in conjunction with other federal programs. In the recent past, subsidy combinations have been important in low income projects, especially in high cost areas and in the rehabilitation of "troubled projects". While the new tax credit may be adequate under special arrangements where there are local subsidies involved, it is not the deep subsidy that will be helpful when used all by itself. Moreover, the subsidies are limited in dollar amounts per state.

The new tax law encourages owners to upgrade their tenancy so that their holdings have the profit-

FIGURE 4.3
CASH FLOW: OLD LAW

Year	Rent	Before-Tax Cash Flow*	Depreciation and Amortization	Tax Savings	Current Return** (percent)
1988	419	(53,260)	$348,093	$192,532	13.1
1989	434	(45,542)	318,402	172,938	12.0
1990	449	(37,688)	291,445	154,546	11.0
1991	465	(29,702)	266,970	137,222	10.0
1992	481	(21,585)	244,750	120,839	9.3
1993	498	(13,340)	224,577	105,284	8.6
1994	515	(4,971)	206,262	90,448	8.0
1995	533	3,519	189,633	76,232	7.5
1996	552	12,125	174,536	62,453	7.0
1997	571	20,843	172,411	42,221	5.9
INTERNAL RATE OF RETURN: 13% After Tax					
SALE		$2,085,913		(923,481)	109.2

*Includes operating income (loss) and mortgage principal payments.
**Tax savings plus cash flow divided by initial equity.

Source: NAHB, *Homebuilding After Tax Reform: A Builder's Guide*, p.14.

able economic character that the new law encourages. They may well want to upgrade or sell. If they are in locations where, by replacing the low income tenants with more affluent tenants, they can raise their rents, they will be inclined to do so. In cases where outside investors are involved, fiduciary obligations require higher rents. Lenders will concur in this conclusion and not seek the often complicated "workouts" that have made it possible to make some private rental units have below market rents.

There are several other impacts of tax reform. The National Association of Home Builders (NAHB) estimates that the effect of various provisions of tax reform on housing construction might be to reduce housing starts[1]. Casual estimates have placed the loss at approximately 300,000 starts during the first year. This is roughly 15 percent of the 2 million total volume in recent years. Such estimates have to be viewed cautiously since the number of housing starts is influenced by a large number of factors. Nevertheless a depressive effect would tighten some markets considerably. This impact represents further pressure to raise rents even as the total investment picture does not encourage new construction.

The NAHB also estimates that the tax reform package will reduce the value of *some* rental properties. The extent of the decline will depend on the investor assessment of local factors, as well as the final estimate of the tax issues associated with such investment. If rents are not raised quickly, and if investors do not anticipate a rapid rent increase, resale values of existing properties could decline by as much as 30% in less viable properties. In other properties, rents are more likely to rise. While rent increases due to changes in the tax law are variously estimated at 15-30%, there is no certainty as to the exact size or timing of the increase. Even in tight markets, rapid rent response may not occur, or will vary depending on market segments. Large increases are likely to be spread over several years since rental properties turn over slowly and investors are loathe to make increases which could result in increased vacancies.

Even where rents could be expected to rise, these increases are not likely to be sufficient to prevent stability or even decline in the value of the properties especially under more conservative investment criteria. In the near term it may be that rent increases may not be enough to offset the loss of tax benefits as a type of return on investment. Rents may already be near what the market will bear in which case investment quality would be reduced. In any case, buyers and sellers as well as those in the lending industry are likely to take a more cautious view of values and prices.

FIGURE 4.4
CASH FLOW: NEW LAW

Year	Rent	Before-Tax Cash Flow*	Depreciation and Amortization	Tax Savings	Current Return** (percent)
1988	419	(53,260)	$136,627	$48,607	(0.1%)
1989	434	(45,542)	$136,627	45,948	(0.1)
1990	449	(37,688)	$136,627	43,197	0.1
1991	465	(29,702)	$136,627	40,348	0.1
1992	481	(21,585)	$136,627	37,395	1.5
1993	498	(13,340)	$136,627	34,333	2.0
1994	515	(4,971)	$136,627	31,153	2.5
1995	533	3,519	$136,627	27,848	2.9
1996	552	12,125	$136,627	24,410	3.4
1997	571	20,843	$136,627	20,829	3.9
INTERNAL RATE OF RETURN: 7.6% After Tax; 6.9% After Tax (Passive loss limit binding)					
SALE		$2,085,913		(851,203)	116.0

*Includes operating income (loss) and mortgage principal payments.
**Tax savings plus cash flow divided by initial equity.

Source: NAHB, *Homebuilding After Tax Reform: A Builder's Guide*, p.14.

1. For a discussion of this point, see NAHB, *Homebuilding After Tax Reform* (Washington: NAHB, 1986), p.10.

Chapter 5

Decision-Making and Housing Loss: Alternative Scenarios

... [If] after assessing such conditions (local market conditions), an owner prepaid a subsidized mortgage, we believe that due to local neighborhood conditions and the market for such units a majority of units would remain available for low and moderate income use. Only a few projects in very good areas and in healthy condition would convert to high income use.

(R.H. Cushing, Department of HUD, June 1986)

...the FY '85 inventory was 1.9 million units. Expiring Section 8 contracts and mortgage prepayments would reduce this inventory. We estimate that the fiscal year 1995 inventory could range from 1.0 to 1.7 million units and the fiscal year 2005 inventory could range from 174,000 to 850,000 units.

(Naomi Cohn, Organizer FHA Tenants United, quoted to *Los Angeles Times*, September 14, 1986, p. 1)

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These contradictory statements highlight perspectives about how owners will behave in the next decade with respect to the future of subsidized housing. In the foregoing chapters we outlined various potential losses to the stock of affordable housing. In this chapter we relate specific project types to a set of questions and decision-making criteria that owners and investors might apply in deciding how to deal with the properties they own. In particular, we look at issues faced by four types of properties: 1) older projects in good condition and prime locations, 2) older projects in marginal areas or projects in fair to poor condition, 3) newer Section 8 projects in appreciating markets, and 4) private, unsubsidized, low rent properties.

Two caveats are in order as we begin this exploration. First, the lack of detailed information on the assisted projects prevent us from tying these prototypes to specific fractions of the existing stock. We don't know, for example, the percent of projects in each of these categories or the precise range of project features associated with the types presented below. This chapter is the first approximation of a necessary strategic planning task.

Our second caveat is that this discussion is a guess about how the issues related here may be looked at in the future. While in some cases the future is now (i.e., projects with choices to make between 1987 and 1990 are facing these questions now), in other cases, action is several years off. We cannot be sure how investors will behave given the various changes that might occur between now and then, including how their expectations might change. In particular, over the next three years, we will be in transition to a new tax law. This factor alone dictates change each year before the steady state is reached in 1990. In addition, Congress may make changes in the tax law or in housing programs that alter incentives.

For each of these scenarios below, we look at the situation the properties are in, the likely options for action as we see them now, and what action the nonprofit sector or housing advocates can take to preserve the housing as affordable.

Case #1: Older, Well Located Projects in Good Condition

This category includes HUD insured projects built between 1965 and 1974 under the BMIR or Section 236 Programs. They are typically owned privately, though about 30 percent are owned by nonprofits. Limited partners typically hold a substantial interest in these properties, and their fiduciary interests must be kept in mind.

These projects typically are in good locations because either they were built in such locations originally or in fringe areas that have since undergone

extensive development. Most of them are fully occupied and well managed.

The outstanding first mortgages for these developments are typically in the $10,000-$15,000 per unit range. Appraisals would no doubt put their value at substantially more: some units as high as $70,000, a few even higher. Few of these projects have major structural problems and modest cosmetic treatment would place them firmly in the middle income or condo market. Under the subsidy program, their rents typically are in the $200- $300 dollar per month range and their tenants have a median income just under $10,000. Tenants are often long term and turnover is relatively small.

The 20 year period of use restrictions on these properties will begin expiring in substantial numbers in 1989. When asked, owners of these projects indicated that their intention is to prepay the balance of the mortgage. These are the projects that the NCHP says are certain to prepay their mortgages.

From the strictly private perspective of these owners or the agents holding a legal responsibility, there are three principal choices. The first choice is that the owner could prepay the mortgage and sell the property at a price to reflect its appreciated value (without the restrictions that have been in place over the past two decades). If this sale occurs, rents might at least double to reflect the higher cost to the new owner and the pressure imposed by the new tax law to generate a positive cash flow rather than rely on tax benefits to boost returns.

The second choice is that the owner could prepay the HUD mortgage, obtain a new mortgage, take out some cash and rent the properties at a rent that reflects their current market potential. This too could easily be twice the current rents that tenants pay. In this arrangement, however, there is sufficient room for owners to gradually, rather than rapidly, accelerate the rents or even provide some discounted rents for their low income tenants. This implies that the owners get less than 100 percent of the possible benefit.

The third option is the renovation and sale of these developments as condominium projects. Accepting the notion that they may be worth as much as $70,000 - $80,000 per unit, and that there is a mortgage on them for less than $15,000 per unit, owners stand to gain at least $55,000 per unit less cosmetic treatment, transaction costs, marketing, and concessions that might be required or deemed advisable.

Given these options and legal rights of private owners it is unlikely that unrestricted use can be prevented. Capital to invest in these properties is available and waiting to be put together by insurance companies, mutual funds, Real Estate Investment Trusts (REITS), and other large investment intermediaries. The projects offer the prospect of cash return *and* appreciation of asset value. Massive losses of affordable housing are expected from the estimated 20% of the stock that fits this description.

The only possible leverage would be that of a local government that has extended public benefits with conditions attached: for example, a tax break or reduced land cost offered in exchange for building housing for low and moderate income households. Most developments were not built with such tight restrictions; most simply required "residential use." However, these projects are so valuable that modest concessions can be granted without the owners losing all reasonable profit. Modest concessions mean that most of the low and moderate income benefit is still lost.

There is also the possibility that if the units are sold or rented the owner may be convinced to sell a share of the units to a community-based organization or public housing authority or to accept some other arrangement that would protect a fraction of the units for continued low and moderate income use. Such a scheme, however, would only occur if the leverage of some powerful entity such as state or local government were applied.

Case #2: Older Developments in Inner City Areas

There are a number of projects built in the same period that do not have a location that provides

favorable conditions for upscale use, sale, or conversion. Indeed some of these older projects in inner city areas were bailed out of difficulty with Section 8 Special Allocations during the mid and late 70s. While the typical outstanding first mortgage may be similar, they sometimes have a second mortgage attached as a result of the "transfers of physical assets." Therefore, instead of an outstanding mortgage balance of $10-15,000 per unit they may have a significantly larger burden. They may also have Section 8 restriction. (There is debate about how seriously the "soft paper" is taken, but they do represent legal encumbrances and, therefore, have to be addressed.)

Tenants in these developments also pay rents in the mid $200 range. In the next 15 years, these older projects will either have their use restrictions expire or will complete renewal options under their Section 8 contracts.

This type of development will also face three choices. The first is to hold on to the original financing or Section 8 subsidy to see what the situation will be in a few years, including the extent to which the local market strengthens, so as to create benefits from unrestricted use. It is unlikely that these owners would make any substantial investment in their property during this period. As a result deferred maintenance builds up to the point where a relatively sound condition deteriorates to a more problematic status over the 5-7 years for which the waiting might extend. Also, during this period, the tenants would be protected from displacement and from substantial increases in rent, but only to have their day of reckoning put off.

The second option is that the owners may sell these units either in a transfer of physical assets arrangement or in some other arrangement for an amount equal to the outstanding mortgage balance plus an additional $2,000-$5,000 per unit. The original owner would get a modest amount in cash and the new owner would have a project which could then be the basis for a new investment. What happens to the project in the long-run depends on the market, but in any case, the tenants will face rent increases down the line. If the opportunity for higher income use materializes, they will face displacement in the same ways as outlined in the first case.

As tax reform is fully implemented this negative impact becomes more certain unless the current confusion surrounding the rules for "charitable gifts" or "bargain sale" are resolved. The purpose of a "bargain sale" is to create a sale to a nonprofit community based group for less than the fair market value giving the seller a charitable deduction and enabling the nonprofit buyer to keep the housing affordable. Under current rules, for a project to be eligible for "bargain sale" the difference between the fair market value and the sales price must exceed the sum of any recapture of accelerated depreciation and 40 percent of any capital gain. No new rules have been written to put this in the context of the new tax law and as a result there are conflicting interpretations of how helpful this provision is. What is clear is that older projects that have a minimum of extra debt would work best for a "bargain sale".

The third possibility is that the owner could take on a nonprofit partner. State housing resources for refinancing, as well as the rehab tax credits under the new tax law, might serve as the basis for giving the project new life with a new team that is committed and has continuing subsidy to support low and moderate income use. To our knowledge, this has not been done since this is the first year of tax credits. There is no experience with tax credit provisions or with other aspects of this scheme to suggest how extensively this can be used. However, these questions are actively under study by housing officials and advocates.

One significant aspect of this potential outcome is the existing financial characteristics of a project and its market. For example, projects that are overly burdened with debt from second mortgages pose a problem for such an arrangement. Projects located in a seriously declining area where rents for non-subsidized low rent housing are less than the rent in subsidized housing in the area may be difficult to work out. The scheme also requires that the new,

nonprofit owner identify limited partners with whom the property can be resyndicated and who are willing to venture into the unknown territory of low and moderate income housing at this point in time. The new law makes approaching cash-rich corporations rather than individuals (who are subject to new "passive loss" rules) a priority. It establishes rules which complicates syndication and thus reduces its value as a cash source for low and moderate income housing. There is still enough and likely to be continued uncertainty for the next two years, regardless of what conclusions are reached in the present assessment. Further, since the low income tax credit is applied to the unit and not to the development it raises the possibility that this solution may apply to some, but not all, of the units in a project. Displacement might result for units experiencing an improvement but not benefiting from the credit.

The uncertainty of this option underscores the possibility that in this period, slum operators may surface. Buyers who have no long-term interest in the property understand that in the temporary arrangements that might be fashioned and in the uncertainty of the present period, they can milk the property for a period of time after which they can walk away or be bailed out. This would be the case especially if transfers did not involve major cash commitments or sophisticated investors whose attorneys will no doubt protect their clients' interests. State and local government and community advocates have to be especially vigilant both in monitoring private transactions and in designing programs to address this issue.

Case #3: Newer Section 8 Projects in Appreciating Real Estate Markets

A number of Section 8 developments were built between 1975 and 1979 in areas which have since undergone gentrification. Because they are new, these developments typically have a much higher mortgage balance (and interest rate) than the older subsidized properties. Mortgages in high cost areas are as high as $80,000 per unit, though in most places $40-$50,000 is more typical.

Tenants pay only 30% of their income for rent. As long as the Section 8 contract is in force, tenants are secure since HUD pays an average of almost $5,000 per unit per year in subsidy.

In the next few years the owners of these properties may elect to get out from under the subsidy obligation provided that the unit could rent or sell at a more favorable amount. These projects represent the same kind of opportunity for higher return that older, well located subsidized projects have, except that they began with a much higher level of debt. The resulting rents will have to be higher, the opportunities for concessions to incumbent tenants fewer, and the urgency to avoid getting caught without having made an adjustment for a post-subsidy era, stronger.

There is also much less that can be done in the way of "bargain sales" with these developments. These projects have a high market value and carry a heavy debt burden, which when combined with operating costs make it impossible to continue these as low and moderate income housing without long-term and deep subsidies. Most of them will also face large recapture of tax benefits if converted.

All of these features make it difficult to guess what owners will do. A combination of federal and local leverage, combined with the prospect of continued subsidy and higher rate of return, could keep many of these developments affordable to the poor. Where projects do not need significant capital infusion, where large windfalls are uncertain or impossible, where recapture is significant and where tenant organization is strong, the prospects for continued low and moderate income benefit are enhanced for as long as Section 8 or a comparable subsidy is available. When it is no longer available, then this property faces the same scenario as in Case #1 above, except the profit margin may be less.

The same newer, highly mortgaged property located in a nonappreciating or declining area is an

even more serious problem. Its underlying value might well be lower than its mortgage balance. This makes it difficult to justify any of the transfer arrangements that have been suggested up to this point as being favorable to both investors and tenants.

In some cases it may even be appropriate to encourage transfer to owners who might be willing to own properties under these less than favorable investment circumstances. Technically, the "bargain sale" might work better. (While recapture is still substantial, the capital gain is small if any exists at all.) Yet it would still be a hard project to sell to anyone without a commitment to an extended project based subsidy. The long-term future of this major resource may also require new capital investment and other major rule changes, including modest rent increases and higher rates of return– all conditioned on high standards for property management performance. It may also require (in the absence of HUD willingness) a stronger role for local or state housing agencies since such projects require extensive oversight if we fashion a complex set of incentives and regulations to keep it affordable.

Case #4: A Private Unsubsidized Low Rent Building

While the stock of 4 million public and subsidized housing units is significant, an even larger number of affordable units are privately owned and unsubsidized.

The dynamics outlined in Chapter 4 are illustrated in the case of a typical 100-unit apartment complex in good condition with only modest upgrading required. The units presently rent for $400-$500 a month and are valued at $45,000 each. Assume further that the building was recently purchased (1981) and refinanced (1986). The outstanding mortgage(s) are fairly large at $37,000 per unit. Under provisions in the old tax law the property gave the owner a 12% return after taxes. The building is fully occupied with tenants who earn between $14,000-$16,000 per year. The rent schedule represents a situation where rents are at the upper end of the range of affordability for low and moderate income families in the area. Since many tenants are already paying 30% or more for rent there is little chance for significant rent increases without displacement. Higher rents might also raise vacancy levels.

The owner has every reason to anticipate that the new tax law will make the property less attractive to prospective buyers. Marginal tax rates are down, refinancing will be harder to justify, and rent increases will be difficult to obtain. For those reasons the owner may be interested in selling the property but will find few buyers. Under the new tax rules this property may generate a negative return (after taxes) for several years. Since the owner cannot sell the building for an acceptable gain, if at all, as his return decreases, he will be forced to cut costs, probably by deferring maintenance.

This hypothetical scenario is one that we expect many investors in low and moderate rental property will face. The issues faced by those who own less valuable and lower rent properties will be more serious. Those who own properties in need of upgrading will find themselves in an impossible position since tenant income places an effective ceiling on rents and there are few buyers for alternative uses of the property. There is no new stream of income to serve a large debt required to upgrade the building.

Even the owners of many middle income properties will find their options for adequate return reduced. They may have to consider the option of condominium conversion or rent increases for tenants who are already paying a moderate rent.

The above example is typical of the large scale or professional owner. In fact, most rental housing is not owned by large investors or professionals, but by nonprofessional owners who have ten or fewer units. Estimating the response and interests of the large holders is hard enough. Doing the same for the small investor is much more difficult. Many of them are not tax-motivated. Some may not even be investment-oriented. We have no way of knowing how they will react to the issues we have

mentioned, though their response to clients of the Section 8 Certificate Program suggests that they are not interested in renting to the poor, even when money is not the issue. In cases where they see opportunities for investment in rental housing, they are likely to maximize two things – the rents they charge and the quality of tenants they attract. The new investment environment that discourages the professional investor in rental housing, may, on the margin, encourage these smaller operators to hold on to units, but it is not likely to spur production of new units, except perhaps small accessory apartments which can be carved inexpensively from existing structures. While a strong investment motivation is not universal among small scale owners of rental property, the economics of real estate (i. e., sales price, underwriting, etc.) will tilt towards higher rents and other terms less favorable to low and moderate income households.

The result of disinvestment or upgrading will be a continued erosion in the number of unsubsidized units available to low and moderate income families. The erosion may even accelerate. Between 1974 and 1983, the number of very low cost units declined from almost 11 million to just under 9 million, even as there was a 20% increase in the number of families requiring such units. In Figure 2.2, the estimated continued erosion places the number of available units in the year 2003 at just over half the number available in 1974.

Since these losses are in the private stock, the points of leverage are fewer than in the subsidized stock where transfer of ownership, continued subsidy, higher returns, etc. can be helpful in controlling the erosion of housing for low and moderate income families. Beyond the new tax law (which reduces the incentives to invest in housing), there are presently no federal leverage points.

This part of the problem of housing the poor underscores the importance of local programs to address private rental housing. Local government has much more leverage that can be applied in this area. Local programs to date, have focused on owner-occupied housing and subsidized units. A major effort at designing local policy is obviously required. The next chapter explores some options in this regard.

Analysis

The scenarios explored above present a variety of possible outcomes – some positive and some negative – for the goal of maintaining affordable rental housing. They also highlight important conclusions to address in public policy and program design.

The first point is that during the next decade there will be a significant amount of churning in the stock of assisted housing. A significant fraction, perhaps 20-25% of the units, will almost certainly be converted to market use. Another fraction, perhaps one-third, will not be converted but will nevertheless be subject to a new economic regime for which extended subsidies are required if the housing is to remain affordable. We don't know which units these are, even though in the section above, we attempt to summarize the characteristics of each category.

There is also a large number of units, perhaps as many as one-half, which are hard to put in either category. Whether they are transferred fully to private management will depend among other factors, on location, rental market conditions, the nature of their underlying financial condition, the nature of state or local opportunities for new subsidies, and political pressure. This churning is certain and sufficiently large to assume that the future of the assisted stock will be on the nation's housing agenda for a long while.

Second, changes in the tax law may be an even larger force in the long run than the expiration of subsidies or prepayment of mortgages. Tax changes will trigger adjustments in rental housing investment. The new changes require that rental housing investment produce a positive bottom line in order to be viable. General partners operating on behalf of investors have a legal obligation to act in the best interest of their limited partners. These realities have

the effect of raising rents, triggering sales or creating opportunities for new partnerships, resyndications, and a host of other adjustments. Focusing on losses from housing programs is too narrow. The issue is nothing less than the future of low and moderate rental housing in an environment where such housing is no longer subsidized indirectly by the tax system or expanded by the housing delivery system.

The new tax credits, uncertainty about the future direction of assisted and unassisted rental housing, and the risks associated with new rental housing construction combine to increase the role that rehabilitation and restructuring will play in the existing stock. We could well go through a period when all attention is focussed on saving rather than building housing. Thus, the churning may generate a lot of activity and reorganization of the stock while directing our attention away from adding units. This is in spite of the fact that the number of needy families may continue to grow at the current 2-3% annual rate.

While the role of private investors is critical for addressing the issues raised in this report, there are two special concerns. The first is preventing slum operators from moving into the vacuum. The second is helping to create new capacity in the nonprofit sector. Both of these are difficult issues to address. Slum operators have been successful during previous periods of churning in the housing market. They misused federal programs and took advantage of legal or technical loopholes to the disadvantage of tenants and the housing stock. They did what brought them the highest return and dared officials to interfere. Many projects have been know to be in trouble for years before any action has been taken to bring owners in line. In the worst cases, these slumlords walked away from their buildings or engaged in arson and fraud. In addressing the issue of housing loss, we must not create new schemes that encourage or allow their participation.

Community-based housing development organizations, while effective and increasingly prominent in a positive way, are not all equal and not all competent. Indeed, they control a significant portion (28%) of the assisted stock, some of which is in trouble because of poor management on their part.

The still significant ambivalence toward community-based housing among officials stems from the mixed experience of nonprofit sponsors in older projects where the nonprofits were churches, unions, and others who had no track record, and who relied on consultants and nonprofessionals to do development. Many of the projects experienced difficulty and some still do. This past experience is in contrast to the more recent experience where development expertise by nonprofit developers has been more positive and has even been creative. Nevertheless, in engineering a transfer of properties to nonprofits, we need to give more attention to expanding their capacity. We need a better system for choosing among them for particular tasks, for strengthening their weaknesses, and for providing oversight so that the problems with the properties do not get out of hand.

These limitations notwithstanding, some of these groups are early models of the creativity that will be needed in addressing problems raised in this report. Tenants groups, after struggles with HUD to take over projects, have turned troubled projects into cooperatives that secure affordable tenure for their members. There are examples of this in Boston, Baltimore, San Francisco, New York, Dallas, and other cities. All of these efforts were extraordinary, not commonplace events. Special tenant leadership, foundation support, a cooperative local HUD office, and other special circumstances played a role in each of these cases. These conditions do not exist in all communities where housing is at risk, but it is possible to create capacity and to mobilize the resources. That creation is the task ahead.

Avoiding slumlords and improving the capacity of nonprofits will not be sufficient. Of the 50 states, less than a dozen have state agencies with the experience or capacity to develop workouts, to play the

program design function or to provide the policy oversight role that is required. In states such as Massachusetts, New York and California, there is over a decade of experience in state management of the subsidized housing development process (from acquisition to syndication) that would be required if we expect state government to play a major role. Few other states have this experience. The local and regional capacity of HUD has been decimated by a decade of staff cuts and reorganization.

Finally, there is some time urgency to addressing the loss potential described in this report. The volume of housing which will come up in the early 1990s is substantial. Because the pace increases, as noted earlier, this requires immediate planning; otherwise our inaction or lack of preparedness will lead to even greater loss than we project might occur. The several actions and policy changes in the next chapter require at least 2-3 years to put in place.

Chapter 6

Policy Recommendations

In the foregoing chapters, we have emphasized the nature and urgency of the potential loss of housing opportunities. These losses will occur as a consequence of distant past as well as recent public policy decisions, especially at the federal level. In the intervening years from when the housing was put in service to the present, we have had a major change in the notion about the federal role in housing versus the role of the other players. This report has likewise argued that the reliance on the private, commodity-oriented market does not appear to be the reliable partner for meeting the housing needs of the poor. Their profit interests and fiduciary obligations now threaten the long-term availability of as many as one million assisted units and a larger number of unassisted units.

A variety of players on the housing scene have responsibility to act to cut the losses that may occur. This chapter starts with the assumption that whoever the culprit is for the projected losses, all the players have a role to play in reversing the trends. This chapter looks separately at the major players in the system and identifies actions each can take to reverse or reduce the losses that will otherwise occur. While each has a role to play within the existing settings and agencies, the new thrust should be supportive of a network of models that takes housing out of the larger investment games and creates, to the extent possible, housing opportunity than can be maintained in perpetuity for the poor.

There are several other assumptions I have in making these recommendations. First, for a variety of reasons, there will be shifts in the ownership of the subsidized and private rental stock. This occurs normally and will be further stimulated by the developments noted in this report. The significance of this point is that some owners and buyers will be considering the future of this housing and trying to figure out what is best. Their decisions may trigger others to act and so on. There is every reason to assume that each will act in his own best interest and not necessarily in the best interest of tenants or the inventory involved. It is not, therefore, destabilizing for public actors to enter the fray.

Addressing the potential loss problem does not require that we attempt to prevent new owners from coming into the game. The changes in the nature of rental housing suggest that it may even be preferable to get new owners involved in some cases and that public policy might seek to stimulate or encourage "friendly takeovers". The churning described earlier is not, by definition, negative.

In whatever new arrangements, we should maximize the potential for involving capable nonprofit groups and tenants in future ownership and management; for putting each development on a sound footing as affordable housing; and, for correcting physical problems that plague many of the developments. What is at stake is perhaps half of the subsidized stock which, if lost to the poor, will be forfeited.

Beyond new directions within the context of existing arrangements, we should search for new ideas that move us closer to the ideal scheme for housing for the poor – a scheme that is not tied to larger investment trends, is affordable in perpetuity, is capable of self-expansion and regeneration, is owned by an entity that has an interest in maintaining a high quality of life, and which is supportive of resident pride. Limited equity cooperatives have emerged in recent years to address some of these points. One promising idea we have seen for achieving these goals is the "mutual housing association" model which has been implemented successfully in Europe for nearly a century and which is presently being demonstrated in Baltimore. (See Appendix B for a description of this model.)

The Role of the Federal Government

The recommendations for federal action are critical because it is the federal contracts, administrative regulations as well as legislative mandates, that define a major part of the problem.

There is no solution to the problem of potential losses that does not start with federal action. (No distinction is made in these recommendations between action that might be taken by Congress, that by the adminstration and that by the regulatory agencies.) Listed below are several federal policies that I think are important.

1. The federal government should commit to maintaining project-based subsidies to all projects in the subsidized stock when required to maintain affordability.

The recommendation does not suggest a particular level or form for this assistance other than that the assistance be made to the project not the individual tenant. (Vouchers and other direct aid ought to go to tenants in the unsubsidized stock or where there is credible evidence that the poor are able to find units available on a non-discriminatory basis.) Housing in the various programs will require different treatment as will housing facing different scenarios as outlined in the previous chapter. The older projects, in most cases, will require less assistance while the newer projects, those needing major repairs, and those serving low income families in weak markets, will require more assistance. We have done this research without the benefit of all the data needed to elaborate on the analysis or to make this recommendation more specific.

Besides funding to keep projects viable and affordable, a commitment of this support has another purpose. It is to send a message that there is a national policy to save the stock of housing at risk. It is a message that needs to come early, to be unambiguous and part of a strategy. It should also have an appropriate set of standards to serve as disincentives to slum operators or those who would underwrite their activities.

Finally, the assistance should, to the maximum extent possible, be "front end" assistance so as to avoid open-ended, expensive, and inefficient use of public funds. Needless to say, such assistance should be contingent on firm assurance of long-term benefit to the needy.

2. The federal government should use existing authority and should request additional authority to provide incentives to owners of the assisted stock not to take advantage of options to which they are legally entitled but which threaten the loss of the units to the affordable stock.

HUD cannot renege on contracts and agreements nor prevent owners from exercising options to which they are entitled. But just as the future of a fraction of this subsidized stock is not clear to us, this uncertainty applies to the owners as well. For that reason, they may be responsive to incentives to keep housing affordable. The federal government may, for example, allow owners to realize a higher return or create mechanisms by which owners can capture a fraction of the financial benefits that may be forthcoming upon unrestricted use in exchange for not prepaying their mortgage or for renewing a Section 8 contract. Both the carrot and the stick should be available. We would have to develop appropriate "sticks," for example, a low preference rating for future development designation, or stiff penalties, for an illegal conversion.

3. The federal government should promulgate regulations and provide assistance to increase the opportunity for community and nonprofit groups or, if necessary, appropriate for-profit institutions to acquire and manage the subsidized housing.

Nonprofit groups, like for-profit investors, have a mixed record in terms of the stewardship of the subsidized stock. The failures on the part of the nonprofits, however, are rarely deliberate efforts to subvert the purposes of the program and are more often the result of overwhelming circumstances (such as the energy crisis) or inexperience. As a source of long term commitment to low and moderate income housing, community housing developers represent the major potential sponsor that can be counted on.[1] Such confidence should not be

based on sentiment, however. The early poor performance of inexperienced nonprofits should not be repeated. While there are for profit developers who might be appropriate for such benefits, the lower costs at which capable nonprofits can provide housing and the long term commitment to the poor are powerful reasons for encouraging their greater role.

Our confidence would be strengthened considerably, however, if these organizations were given support in building their capacity and if they were part of a local, regional or national network of nonprofits. Such a network would have many advantages including efficiency in the development process and fund-raising, mutual support and the ability to bring major backing to the neighborhood-based development efforts.

The aim of federal policy ought to be to increase the capacity of these organizations. By increasing their capacity it would allow them to take over some of the subsidized stock, enter into partnerships with for-profit companies, try new ideas, or provide development services (i.e. construction management, etc.) as part of a larger housing delivery system.

These groups can also take advantage of opportunities to form cooperatives or mutual housing associations or to create property management organizations. To play this role requires the federal government to support a national program of capacity-building. This means engaging large and successful national, regional or community based organizations to do technical assistance for local groups; changing HUD procedures to allow nonprofits more time to gather resources (i. e. funds, a development team, investors, etc.) to participate in development; granting financial support for the operating budgets of local groups; and providing incentives to profit oriented groups to work with nonprofits.

4. Sponsors who have a poor record in past dealings should be excluded from further participation in programs. Preferred status should be accorded to developers who have an excellent record in their previous experience and to teams that represent viable nonprofit/private partnerships.

The conservation of the subsidized stock is a venture that requires the utmost caution in implementation. There are in each community sponsors who have widely recognized and well documented records as irresponsible owners and sponsors of subsidized projects.

HUD has been criticized for allowing such sponsors to continue to participate in federal housing programs. A federally-led effort to save this housing ought to include strict sponsor performance standards and an assessment of past records so as to separate out the "bad eggs". Almost any policy undertaken to preserve subsidized housing will have provisions which can be abused and which, if abused, will undermine the project.

5. The federal government should develop a plan to address the issues raised in this report.

There are a variety of issues, the meaning and implications of which have been newly transformed by expiring uses and contracts, changes in the tax law, underwriting practices, etc. Owners, prospective investors, tenants, state and local officials, and others need clear signals for what they can expect from the federal government so that the exercise of their choices can be fully informed and hopefully more consistent with national policy. In doing this research, I was struck with the sincere interest in the problem and the puzzlement about federal intentions.

In developing this plan, the federal government should consult and take into account the role that state and local governments can play and the roles that are consistent with the community and resident interests. There is, in local communities, a great deal of experience gained in recent years rescuing troubled housing, forming partnerships, and designing incentives for local developments. This experience, while considerable, has not been directed to the federal stock. The federal government will have to learn from that experience and will have to

develop with these local players arrangements for joint action, which in some cases may involve wholesale disposition of housing to those state finance agencies that have a good track record underwriting and overseeing production and redevelopment of multifamily housing. This point is developed more extensively below. The plan might well require a new agency or other entity – such as a task force or commission – to articulate, organize, and implement a national interest.

6. The federal government should develop appropriate mechanisms for refinancing subsidized or formerly subsidized housing as these projects experience turnover or need refinancing in connection with the issues raised in this report.

As pointed out in Chapter 4, the changed environment for real estate finance will make previously acceptable urban real estate and reinvestment projects appear too "risky." This will be especially so where efforts are made to keep the units affordable. Reduced tax benefits and more conservative underwriting standards will also contribute to a poorer competitive position for low rent housing in the capital market. When this poorer competitive position is recognized by investors and owners, it encourages behavior on their part that is not supportive either of helping the poor or of maintaining the quality of the housing stock.

Under these circumstances, the federal government, through the Government National Mortgage Association (GNMA) or some other mechanism, should assure that adequate financing exists for projects which need it and which are consistent with other proposals in this report. Providing financing is a separate matter from any consideration of subsidy which may also be required.

The Role of State and Local Government

Listed below are suggestions for state and local government initiatives. Contrary to my initial thinking, there is a considerable amount that can be accomplished at the local level especially with regards to regulatory action.

1. State and local authorities should review the terms of their arrangements and contracts regarding subsidized housing and tenant protections in unsubsidized housing to determine if their obligations and rights extend beyond the terms of the HUD contract, and whether in disposition negotiations, local government has standing to take an action different than what HUD might take.

A significant but undetermined portion of the subsidized stock was built on urban renewal land, other public land or in connection with government action justified as a benefit to housing low and moderate income families. My research did not establish that there is a general provision requiring "low and moderate income" benefit in connection with urban renewal though local communities might have held other requirements. What is typically required in some contracts is that the land be used for "residential" purposes since that is the legal requirement of the urban renewal statute under which the local community acted. There are, however, a few sources of leverage that may be applied. In cities that have rent control, federally subsidized housing is excluded, typically because rents are set in connection with the terms of the HUD agreements. As those agreements expire, rent control may be activated for this stock just as it applied to other housing in its type class.

State laws regarding foreclosure and rules regarding the authority's power to dispose of public housing are other issues where state action may be helpful. For housing with extensive code violations or financial difficulty, states which have housing receivership statutes can intervene to develop workouts favorable to its construction of the public interest.

For states with a strong housing agency, the list of possible actions is much longer and suggestions are touched on elsewhere. In general, those states

have "sticks" with which they can influence housing investment. They can assist nonprofits and support positive actions undertaken by local government. They can allocate "tax credits" and grant preferred "status" to developers that influence their ability to do business with the state agency in other projects.

2. Local government should use block grant and other funds to provide operational support for the development of tenant cooperatives, mutual housing associations, and nonprofit organizations that take over housing subject to potential losses.

In a variety of ways, we have suggested the importance of nonprofits in the future of subsidized housing. For them to take this role means that they will need support in getting organized, seed money to help them get into the game, technical assistance, etc. While foundations and national organizations like the Neighborhood Reinvestment Corporation have to play a major role, this needs to be expanded and the amount of funds increased. New ideas such as mutual housing and public-private partnerships need support for an adequate demonstration. Massachusetts, for example provides a basic operating grant to more than 30 CDCs in the state. While the sum is modest – about $30,000 per year– it is the critical first dollar for many organizations. In the larger cities, there are already organizations that play this role or could play this role. These city-wide groups sponsored by Neighborhood Reinvestment (its Apartment Improvement Program or multi-neighborhood NHS groups, for example), Local Initiatives Support Corporation (LISC), and the Enterprise Foundation, among others, are the ones that are already actively involved in this issue. Because the issue of loss of affordable housing is not a neighborhood issue, city-wide (even region-wide) attention is required. In some cases, cities can assist organized tenant groups directly, or take up advocacy on these matters as a local government action.

3. Local governments could consider purchasing available subsidized projects for use as public housing or as housing to be sold under state subsidy to tenants.

States should purchase or support local government purchase of assisted projects or units for use as public housing. These units might be held indefinitely or later sold to nonprofits who would agree to lease them only to low and moderate income families. In the former case, the suggestion is to use purchase as a limited tool to be used only when time is of the essence and no other acceptable buyer is available. Eminent domain may be useful in this case especially if the local government played a role in establishing the housing resource.

4. States should consider using existing power to regulate for health and safety.

State and local agencies could require physical improvements and other concessions to protect the interests of tenants. Many of the projects that will be up for review have serious physical problems. Since real estate transfers have to address the condition of the property (for example, is the property consistent with codes), regulators could decline to be a party to any transfer that does not address the issue. In New York, New Jersey and Massachusetts, local regulations have been used to attach conditions for transfer and refinancing that, for example, require the new owner to correct code violations and to establish an escrow or present a line of credit to cover future financial and physical contingencies.

This suggestion is not that regulators ought to "hold up" owners. It simply suggests that there are legal ways to influence the character of transactions that occur when there is a clear public interest involved and where public resources have been committed to owners in exchange for affordable housing. The regulations also provide tenants and the public with leverage since they can pursue defensive legal action based on these protections.

The Role of Community-based Housing Organizations

Listed below are some of the roles that community-based groups can play and some of the actions they can take. My assumption is that community groups can play a major role for projects which are no longer of interest to private owners and that these groups should play a role in empowering residents and tenants to act in their own best interest.

I also assume, that in a given city, different community groups will play different roles and that these roles are, in many cases, already being played to build or rehabilitate property, but are not directed to the issues of preventing the loss of affordable housing.

1. Local groups can become advocates for activities that preserve housing and can oppose trends that cause housing loss.

In the course of doing this research, I discovered no systematic network of advocacy on the issue of housing loss. There was nothing to compare with the level of networking on such issues as "redlining," homelessness or fair housing, for example. This is not to suggest that there is widespread ignorance of the problem. There is an awareness of the issue, but ignorance of the details of the problem and a dearth of ideas about how to deal with it. In the past couple of years, the Low Income Housing Coalition, the National League of Cities, the National Association of Homebuilders, The National Housing and Rehabilitation Association, The National Housing Law Project and various trade groups have all given some attention to the issue. Large investment houses explored whether there are investment opportunities in this stock. A few local groups have explored the issue – Common Ground in Dallas, the San Francisco Anti-Displacement Project, The Affordable Housing Coalition in Boston, Chicago's FHA Tenants United, among others.

We have made the point that the loss process we project has been set in motion. The losses will occur unless something is done to stop them. There is a critical need for advocacy on the part of tenants and others concerned about low and moderate income housing. If that advocacy is not forthcoming, then others will move to advance their own interests, perhaps at the expense of the tenants or the housing at risk. There needs to be an equivalent of this report at the local level, further research on how to take advantage of present options and development of legislative and administrative agendas.

2. Since the issues raised in this report are not isolated to particular neighborhoods, citywide (or area wide) housing organizations and low income advocacy groups should adopt this issue. If no such groups exist, then they should be formed.

Unlike the case of traditional reinvestment activity where the mobilization and advocacy are at the neighborhood level, the issues of housing losses are generally not neighborhood specific. Advocacy is most efficient when done on a citywide or even county wide basis. In several cities, Neighborhood Reinvestment and other groups have citywide coalitions with whom they have been working. These groups, or new ones, would be the most appropriate vehicle for advocacy.

The agenda for these groups need not be limited to advocacy. They may become development groups or providers of technical assistance to tenant groups that organize in individual projects. They could be the vehicle for state and local government action, which in most cases is not done by government agencies but groups that have contracts.

More than a quarter of the subsidized units are owned by non-profit sponsors. These groups, and the organizations that support them, should explore ways to strengthen their own projects. (The report does not focus on these groups because the units they own are not subject to loss in the same way as other units are. It is clear, however, that nonprofit sponsors own some of the least viable and most

distressed properties and, therefore, they are at risk as well.) While recommendations to the federal government to shore up the financial condition of the subsidized inventory would apply to these owners as well, many of the problems they face are not financial. Instead they relate to management and other issues over which locals have substantial influence. The developments may also choose to change the form of ownership, perhaps converting to cooperatives or mutual housing associations.

Roles for The Neighborhood Reinvestment Corporation

The following recommendations are made regarding roles that the Neighborhood Reinvestment Corporation can play. Generally, these recommendations are proposed as extensions of the focus on partnerships and leverage that has characterized Neighborhood Reinvestment from the beginning. I further assume that Neighborhood Reinvestment will play a role with NHSs that is consistent with the suggestions made above for community based housing organizations.

1. Neighborhood Reinvestment should continue to develop training and information programs that expand the capacity of local groups and enable them to take advantage of existing options and the legislative and regulatory shifts that might be forthcoming.

2. In the coming months Neighborhood Reinvestment should participate in the debates that will emerge on this issue of losses. In particular, it might report on the successful experience of its AIP program in "rescuing distressed multi-family properties" and suggest how this can be part of the solution.

3. Neighborhood Reinvestment should consult with HUD and federal regulatory agencies on possible roles it can play, for example, in demonstration programs these agencies might sponsor. Neighborhood Reinvestment might highlight its relevant experience to agencies that regulate or oversee financial institutions and in its dealings with local lenders with the goal of working out a partnership solution to developments that might otherwise be lost to the affordable stock.

4. Neighborhood Reinvestment should do an assessment of AIP on the situation in the 17,000 units that have been rehabilitated in recent years to make sure that new trends don't threaten the viability of these developments. There may be a lesson for others in the experience and it would alert us to any problems with that stock of housing, especially projects done after 1980.

5. Neighborhood Reinvestment should seek federal and private support for expanding the mutual housing model it has demonstrated in Baltimore. The demonstration should test the viability of the model for rehabilitation as well as new construction and in a variety of market and neighborhood settings. Following the basic partnership approach, the Neighborhood Reinvestment Corporation should seek over a 5 year period to establish the skeleton of a national network. The demonstration should be documented so as to provide the basis for broad replication.

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Many of these recommendations hinge on Administration/ Congressional action. This first step is necessary, but not sufficient, since implementation of efforts at saving units from loss have to be carried out by other actors. We cannot rely on the private sector to do anything except what is in its own best interest and we have, via tax reform, greatly reduced the interest many private owners have in the low and moderate income sector of the market. Thus, to achieve an effective policy we must have policies that provide:

- sufficient, and preferably, front end subsidies;
- mechanisms to protect affordable housing in perpetuity;
- incentives for private cooperation to make *the owners* interest more consistent with *the national interest*; and
- a means to encourage transfering ownership of assisted units to sponsors who have an interest in managing housing under the conditions that we have outlined.

Conclusion

We set out to explore the extent to which housing we have counted on to meet the needs of low and moderate income families is at risk of loss. We have concluded that the potential is real and, despite data problems, we can estimate the extent of risk over the next 20 years. For the stock of subsidized housing, we estimate that half of the units are on the road to loss of their contractual protections for low and moderate income use. An estimated 20 percent of the total is virtually certain of loss and the rest can, to some degree, be preserved by means of the recommendations that we offered in the chapter. The other half is safe for low and moderate income families, though some of it will need assistance to avoid disinvestment.

We also concluded that there will be some shrinkage in the stock of unsubsidized low rent units – at least 20 percent and perhaps more – if the worst fears of tax reform and more conservative urban lending come to fruition.

Beyond these estimates, there is the larger issue of the change in the nature of our national housing policy. The change is significant not only with respect to the issues of loss, but for the issue of production as well. Unlike the period when low income housing production was the goal, we presently have a widely accepted (or tolerated) policy where government does not have a major role and housing is left to the vagaries of the market. The market cannot produce or maintain housing for the poor and the policies that exist to assist in this area are far from adequate.

Our best hope is that we can build the skeleton of a network of community-based housing development enterprises that, with appropriate legislative and other changes, and assistance from various sources, can be the engine for reversing this trend.

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1. For a review of the experience in this regard, see Phillip L. Clay *Community Based Organizations as Housing Developers*, a working paper of the Center for Real Estate Development of the Massachusetts Institute of Technology, 1986.

Appendix A

Major Relevant HUD Multifamily Housing Programs*

Multifamily Rental Housing for Low- and Moderate-Income Families Below Market Interest Rate Program Section 221 (d) (3) and (4)

Mortgage insurance to finance rental or cooperative multifamily housing for low- and moderate-income households.

Nature of program – To help finance construction or substantial rehabilitation of multifamily (5 or more) rental or cooperative housing for low- and moderate-income or displaced families, HUD conducts two related programs. Both insure project mortgages at the FHA ceiling interest rate. Projects in both cases may consist of detached, semidetached, row, walk-up, or elevator structures. The insured mortgage amounts are controlled by statutory dollar limits per unit which are intended to assure moderate construction costs. Units financed under both programs may qualify for assistance under Section 8 if occupied by eligible low-income families.

Currently, the principal differences between the programs is that HUD may insure 100 percent of total project cost under Section 221(d)(3) for non-profit and cooperative mortgages but only 90 percent under Section 221(d)(4) irrespective of the type of mortgagor.

Formerly, the two programs were distinguished by these additional differences. Projects financed under 221(d)(3) could qualify for a below-market interest rate (as low as 3 percent) and for rent supplements. Consequently, these projects were limited to a lower statutory cost ceiling per unit than we allowed under 221(d)(4) projects which did not benefit from these subsidies. Below-market interest rates and rent supplements are no longer available for new projects for these programs.

Cumulative Net Completions: 126,000 (FY 1985)

*Source: *Programs of HUD*, U.S. Department of Housing and Urban Development

Section 236 Rental Housing Program

The Section 236 program, as enacted in 1968, provided a subsidy to reduce mortgage interest payments on multifamily housing projects. The maximum subsidy available to a project was set at the difference between the monthly payment for principal, interest, and mortgage insurance premium on the outstanding mortgage at the market rate of interest and the monthly payment that would be required under a mortgage bearing an interest rate of 1 percent. New contract approvals under Section 236 were discontinued in January 1973 except for "bona fide" commitments outstanding at that time.

A basic rental charge that was deemed sufficient to meet operating expenses plus debt service expenses at the 1 percent rate of interest was determined for each unit. Every tenant is required to pay the basic rental charge or 30 percent of income – whichever is higher. This means that while moderate income tenants pay a proportionate share of their income for rent, the expense to the very low-income families in Section 236 projects often may exceed 30 percent of income.

The Housing and Community Development Act of 1974 also authorized a "deep subsidy" program to aid the very low-income families in Section 236 projects. Under the deep subsidy program, HUD may provide additional subsidies equal to the differences between the basic rent and 30 percent of income for a certain percentage of units. Generally, 20 to 40 percent of the units in a project are deemed eligible, but there are exceptions should the Secretary determine that a higher or lower percentage is needed to assure an adequate income mix for economic viability.

While new approvals for this program were discontinued in 1973, by the end of Fiscal Year 1982, 536,000 multifamily units were eligible for payments under the program. As of the end of Fiscal Year 1982, approximately $29 billion in budget authority was obligated under this program.

Cumulative Net Completion: 530,000 as of FY 1985, more since 1973.

Low-Income Public Housing

Year of Enactment

1937

Nature of Assistance

Full subsidy of capital costs and those operating costs of publicly owned housing that exceed 30% of tenant income. Subsidy paid to local Public Housing Authority (PHA).

Tenant Eligibility

Income lower than 50% of the area median, adjusted for

family size. Local PHAs may apply further prioritizing criteria, such as family size or age.

Rent Issues

Tenant rent contributions are being raised from 25% to 30% of income on a phased-in basis. These increases, and a reduction in eligible income limits from 80% to 50% of median, were enacted in 1981. Major outstanding issue is the need for rehabilitation of many older projects, as well as the perennial issue of how to best manage the projects and to restrain operating costs.

Cumulative Net Completions, 1,362,000 (FY 1985).

Current Activity, 7,000 in FY 1986.

Lower-Income Rental Assistance

(Section 8)

Aids lower-income families in obtaining decent, safe, and sanitary housing in private accommodations.

Nature of program - HUD makes up the differences between what a lower-income household can afford and the fair market rent for an adequate housing unit. An eligible tenant must pay the highest of 30 percent of adjusted income, 10 percent of gross income or the portion of welfare assistance designated to meet housing costs. Housing thus subsidized by HUD must meet certain standards of safety and sanitation, and rents for these units must fall within the range of fair market rents as determined by HUD. This rental assistance may be used in existing housing, in new construction, and in moderately or substantially rehabilitated units. Not more than 10 percent of units available for occupying prior to August 13, 1981 and 5 percent of units that become available after that date may be rented to lower-income families whose incomes are between 50 percent and 80 percent of median.

Nonprofit and profit-motivated developers, alone or together with public housing agencies, submit proposals for substantial rehabilitation or new construction in response to invitations from HUD; or they may apply to their State housing finance agency. On approval of the proposals, HUD contracts to subsidize the units to be occupied by eligible families.

To assist HUD in managing its responsibility for BMIR and Section 236, Congress enacted the Section 8 Loan Management, Property Disposition and Conversions in 1974. These programs have provided flexibility to HUD in managing its commitments under earlier programs. Section 8 Loan Management program subsidies financially distressed projects built under Section 221(d)(3) and Section 236. Section 8 Property Disposition contracts are provided to permit low-income tenants in a foreclosed property being sold by HUD to remain in the project. The Section 8 Conversion contracts replace Rent Supplement contracts. The commitment to owner is for 5-15 years.

Recent Issues – These continue to be funded because of their usefulness in dealing with problem properties on a case-by-case basis.

Current Activity, 10,000 in FY 1986.

Appendix B

The Mutual Housing Association Model

Mutual housing is a form of rental tenure where the "tenant" leases from an association of residents and community members who are the owners of the property. The tenant has an indefinite lease and participates in the governance of the association. Unlike a cooperative, the tenant does not "own" a share of the corporation.

The Mutual Housing Association (MHA) is a state chartered 501(c)(3) organization governed by a board whose members include mainly residents but, in addition, includes members of a local partnership of lenders, local government, etc. Accountability is maintained as specified in by-laws that conform to contracts with subsidizers and to state laws for such nonprofit corporations.

The Mutual Housing Association is the housing developer and it maintains a continuing role in the management of the property. The association also raises funds. Mutual Housing has a unique means of financing and herein lies its unique contrast with profit renial housing and cooperatives, including limited dividend cooperatives. The points below summarize financial aspects of mutual housing.

1. The MHA raises capital to invest in the construction or rehabilitation of housing for low and moderate income families. Under preferred conditions, the entire financing of the housing comes from the use of this grant, but it may constitute a fraction of the total development cost – the larger the fraction, the more affordable the housing.

2. Tenants make a one time membership fee of a few hundred dollars. This is also invested in the property. At the end of the development period, the development is paid for or the amount mortgaged is only a small fraction of the development – in contrast to typical development where the mortgage almost equals the development cost.

3. Tenants pay a monthly fee to cover operating costs and a contribution to repaying (to the Association) the original capital grant. There is no interest on the capital grant so that there is no debt service. This results in a monthly housing cost that excludes profit, interest and amortized development fees, and expenses. The payment each month is much more modest.

4. The funds repaid to the capital fund may be used to construct new housing, to maintain the quality of life in the initial project or to meet urgent needs faced by residents. It may also be used to acquire additional inventory by direct purchase.

The implementation of this model addresses many of the problems documented in this report. The housing is affordable and permanently available to the poor. There is a one-time up-front subsidy of a certain size. There are resources to maintain the property over time. There are no perverse motives hidden behind tax laws, limited partnerships, or regulatory motivation. There is capital generated to support the expansion of the affordable stock without new authority. All of the parties have a motivation to maintain the property since they are board members of the association, or residents. (There are also provisions for "waiting members" and community residents to participate in governance.) While this is rental housing, a "pride of ownership" cannot but help to emerge and strengthen this financial arrangement.

Appendix C

Low Income Housing Tax Credit

Fact Sheet

General

The Low Income Housing Tax Credit, created in the Tax Reform Act of 1986, is the key tax benefit available for use in low income housing investments, and replaces virtually all previously available benefits to low income housing, including accelerated depreciation, 167(k), etc.

Eligibility

A qualified low income housing project is one in which:

1. 20% or more of the units are rent restricted and occupied by tenants whose income is 50% or less of median income, or

2. 40% or more of the units are rent restricted and occupied by tenants whose income is 60% or less of median income.

A rent restricted unit is one which the gross rent does not exceed 30% of the relevant income limitation cited above. (Gross rent does not include federal Section 8 or other state and local rent subsidy payments.)

A qualified low income building is one which:

1. is part of a qualified low income housing project throughout the 15 year compliance period of the credit, and

2. is subject to new depreciation rules in the Tax Reform Act of 1986, and

3. is placed in service between 1/1/87 and 12/31/90.

Credit Amount Calculations

The amount of the annual credit, available for a ten-year period, is calculated according to the following formula:

Qualified Basis x Applicable Fraction = Eligible Basis

Eligible Basis x Applicable Percentage = Annual Credit Amount

Qualified Basis is the development cost of a new construction project, less land costs and in some cases, federal subsidies.

Qualified Basis in an existing project would include acquisition costs (excluding land) plus rehabilitation costs, less federal subsidies in some cases.

The Applicable Fraction is the lesser of low income units to total units and low income floor space to total floor space.

The Applicable Percentage is determined on the basis of project type (i.e., new construction vs. rehabilitation) and by the use of federal subsidies, as shown below:

	Rehabilitation		New Construction	
	Rehab= more than $ 2,000/unit	Rehab= less than $2,000/unit	Acquisition Cost	Construction Cost
A.	4% or	4%	4%	4%
B.	9% or	4%	4%	9%

A. Federally Subsidized Projects*
B. Unsubsidized Projects

*Includes mortgage financing with federally subsidized tax exempt bonds and/or below market rate federal loans or grants for which Qualified Basis is not reduced.

State Credit Limitations

State agencies will allocate credits to projects and allocations are completed during the year in which the project is placed in service. Each state is limited to a total credit cap of $1.25 per capita for the years 1987 through 1989. This amounts to approximately $7.5 million for Massachusetts, for each of those years. However, only the first year of a project's credit is counted against the cap. The 4% credits used in tax-exempt bond-financed projects are not subject to the credit cap either, since they are controlled instead by bond caps.

Massachusetts could more than quadruple the total credits available under the bond and credit caps by allocating all or substantially all of its bond cap to multi-family housing bonds, and maximizing its use on bond financing to 70% of the total development cost of low income units.

Individual Investment Benefit Limitations

No individual investor may claim more than $7,000 per year in the low income housing credit against salary- or portfolio- generated tax liability, because of limits related to other passive loss restrictions. Additionally, the amount of credit available to individual investors is decreased ratably to 0 as individual income increases from $200,000 to $250,000. Therefore, credit transactions must be oriented to corporations not affected by passive loss restrictions, or to larger numbers of individual investors, requiring public offerings for all but relatively small projects.

Appendix D

Selected Cases in Demonstration Program

Denver, Colorado

The Denver Housing Authority proposes to convert 64 units in the Curtis Park/Arapahoe Village developments to home-ownership. The home-ownership project is part of a five stage comprehensive development plan for the Curtis Park/Arapahoe Village developments, which are in a neighborhood currently undergoing revitalization. The homeownership project will complement and further enhance these public and private efforts.

The approximate sales price of the units will be $25,000 and the minimum eligibility income threshold will be $12,000. PITI for the units will be $250 (which represents the cost of private financing of rehabilitating the units), with total homeownership costs at about $400 per month. This amount represents slightly more than a 30 percent housing cost to income ratio. Financing will be provided either by the Colorado Housing Finance Agency (CHFA) or the city through a bond. A down payment of $1000 to $3000 will be required and the terms will be 30 years at 9 percent (maximum). The Housing Authority is also looking at a variety of sources to further reduce all financing costs including down payments.

The project represents a unique public/private initiative. While the Housing Authority will retain ultimate control of the demonstration and select the purchasers, day-to-day management of the rehabilitation, securing the financing and training the cooperative association will be done by the Denver Community Leadership Forum, which is comprised of all the public and private entities – the city, CHPA, private developers, financial institutions, architects, and an existing public/private partnership – needed to assist this project.

Washington, D.C.

The D.C. Department of Housing and Community Development proposes to convert Wylie Courts, a development which contains 28 units, to homeownership. This development was originally constructed under the Turnkey III program. The development is currently operating as a rental project.

Wylie Courts is in good condition, needing only minimal repairs which will be funded from the city's Neighborhood Improvement Program. It is located in the H Street Revitalization Area, an area of heavy public and private reinvestment. Wylie Courts will be converted to a condominium.

The Housing Authority has set a sale price of $40,000 to $50,000 per unit, based on the purchasing families' income, for both developments. Total monthly housing expenses are estimated to run approximately $460 to $575 per month, representing 30% of an eligibility income of $19,000. Financing will be provided through the D.C. Housing Finance Agency. A down payment of 5% of the sales price will be required. However, purchasing families will be credited with the amount they would have put towards a down payment had the Turnkey III program been operational at this site – approximately $3500. Terms will be 30 years at 10.75 percent. The Housing Authority will hold second mortgages on the units based on the difference between the first mortgage, which is set at affordability of the purchasing family, and the fair market value. These second mortgages will ensure the continued availability of the units for low income housing by being deferred and rolled over to subsequent purchasers.

The Housing Authority proposes to use some of the sales proceeds generated from these sales to purchase city- owned housing to add to their public housing inventory.

Chicago, Illinois

The Chicago Public Housing Authority proposes to convey 30 single-family detached and single-family duplex units in the Wentworth Gardens development to homeownership. The proposed units are in a section of Chicago that has a large concentration of public housing. The units are all brick construction and are in sound physical condition. The units will be priced from $30,000 to $48,000 in a neighborhood where comparable housing averages $50,000 to $65,000. It is expected that the eligibility incomes necessary to afford the full cost of homeownership in these units will be from $15,500 to $23,000. There are approximately 30 families in the development that have expressed an interest in homeownership and their incomes range up to $31,400.

The Housing Authority will provide extensive pre- and post- sale counselling to the purchasing tenants. They will recapture capital gains during the first five years following sale. Presently, financing has not been arranged, but the Chicago Housing Authority is confident of its ability to secure lines of credit from the six to seven banks with which it does business. A portion of the sale proceeds will be used to establish a fund for the purchasing families for extraordinary maintenance and repair expenses which may occur in the first few years of ownership.

Baltimore, Maryland

The Housing Authority of Baltimore City (HABC) will make homeownership available to qualified current occupants of scattered-site public housing. The housing authority will thoroughly screen interested current tenants and provide qualified families with extensive counseling and training in the responsibilities of homeownership. Units to be selected for the program will meet local code prior to their sale.

HABC will directly finance low interest mortgage loans for the sale of the properties, which will be sold for appraised value (in the range of $25,000 to $35,000). The eligible annual income to support the full cost of homeownership is estimated to be approximately $25,000 with estimated monthly housing costs of $300. The new homeowners will be required to make a down payment and to pay taxes on the properties. During the three year demonstration, HABC expects to assist 30 families to become homeowners (nine families have already been identified). HABC will train residents to assist staff in the homeownership counseling.

Lowell, Massachussetts

The Lowell Housing Authority proposes to convert the Harold Hartwell Court development, which contains 25 units, to homeownership under a cooperative form of ownership. The development is a self-contained project of attached townhouses. The units are in good condition, but need some replacement of exterior siding and landscaping (which will be financed as part of the mortgage). The project is located in a stable neighborhood which is undergoing some upgrading and private revitalization.

The Housing Authority has set a sale price (based on affordability of the current residents) which range from $0 to

$20,000 depending on the family income. Total expenses for homeownership are estimated to run between $250 and $335 a month, depending upon family income. The Housing Authority estimates that a minimum income of $13,500 would be necessary to afford the homeownership costs. Approximately half of the current tenants can afford to and have expressed an interest in becoming homeowners. The sales will be structured so that purchasers will have an average housing cost to income ratio of 35 percent of gross income.

Financing will be provided by the Massachusetts Housing Finance Agency or through Section 312 loans, depending on which provides a lower financing cost. A down payment of $100 will be required. Terms will be for 25 to 30 years at a 7 percent (maximum). The Housing Authority will hold second mortgages on all units for 25 years which represent the difference between the affordable first mortgage and the appraised value of the unit. The purchaser must repay the second mortgage at resale. At the end of the 25 years, the Housing Authority will cancel all outstanding second mortgages.

Wyoming, Michigan

The Wyoming (MI) Housing Commission proposes to sell 63 scattered-site, single-family units to current residents of the properties. The units are to be sold at approximately 60 percent of the fair market value – about $30,000. The sale price will be adjusted downward so that the majority of families can be made eligible for homeownership. However, not all families are expected to qualify. The properties are in excellent condition and are scattered throughout the city of Wyoming.

The Wyoming Housing Commission has tentatively identified a private source for financing the units. They expect to phase in the sales with 20 units being sold the first year, 20 the second year, and then the balance of the units in the third year of the demonstration. Residents will be required to pay between $400 and $1000 down payments. These down payments will be pooled into repair fund to which homeowners can apply for emergency repair money. There will be a capital gains recapture during the first five years which will be reduced over the next five years. Also, during the first five years, the Wyoming Commission will continue to make payments in lieu of taxes to the local government.

Paterson, New Jersey

The Housing Authority of the City of Paterson proposes to convert the Brooks-Sloate Terrace development, which contains 242 units, to homeownership. The form of ownership is to be a cooperative. The development is a self-contained project of attached townhouses. The units are in good condition, but need some replacement of exterior siding and some grounds work and street repaving. The Housing Authority has submitted an application for FY 1985 Comprehensive Improvement Assistance Program funds for these activities.

There will be no mortgage on the development. Instead, purchasers will be given three years to build up an equity share of $2000 to $3000 before they can purchase a share in the cooperative. Total housing expenses are estimated to run at about $250 per month, depending on income. The Housing Authority estimates that a minimum income of $10,000 would be necessary to afford the homeownership costs. Approximately 60 percent of the current tenants can afford to purchase. Purchasers will have an average housing cost to income ratio of 30 percent of gross income.

In order to ensure the long-term feasibility of the cooperative to generate additional low-income homeownership opportunities, the Housing Authority will create a city-wide Mutual Housing Association. This association, which will be initially capitalized with some of the equity build-up from the Brooks-Sloate Terrace conversion, will provide technical assistance and counseling to the cooperative for an extended period of time after title has passed. It will also work with non-profit developers to create other new low-income cooperatives in the City of Paterson.

Tulsa, Oklahoma

The Tulsa Housing Authority has identified 100 units in the Seminole Hills Annex to be used for a homeownership program. The units are single-family clustered townhouses which are in good sound quality condition. The program has widespread community support (Mayor, Urban League, local banks, etc.).

A sales price of appraised value is anticipated with the PHA being a co-mortgagor on the outside private financing of 60 percent of the sales price and the remainder to be covered by a silent second mortgage to be held by the PHA to ensure that windfall profits cannot be made through resale of the units within the first ten years of ownership. A lease-purchase arrangement of not less than one year will be made with the eligible tenants. During this time the tenants will be building up equity for the down payment and funds to cover the closing costs. A small down payment will be required. To be eligible, tenants must have sufficient income (estimated to be between $12,000 and $16,000) to afford the private market financing and all other costs associated with homeownership.

The PHA and others (i.e., the Urban League and the Oklahoma State University Extension Homemakers Service) will be providing counseling and training in the responsibilities of homeownership and basic home maintenance.

Philadelphia, Pennsylvania

The Philadelphia Housing Authority plans to sell up to 300 scattered site single-family homes occupied by public housing residents. The units to be sold will be selected from among the 5400 scattered site properties the housing authority owns, on the basis of the current occupant's interest and ability to afford homeownership, and the amount of rehabilitation work the property might need. The price will be set on the basis of affordability to the prospective tenant purchaser, with a minimum price of the cost of any rehabilitation, and the maximum price based on the appraised value of the property. It is expected that the eligibility income to participate in the homeownership program will be approximately $12,000.

The Philadelphia Housing Authority expects to accomplish the needed rehabilitation work from a revolving loan fund to be established with funds provided by the Philadelphia Urban Finance Corporation. Permanent mortgage financing will be sought from private lenders. The PHA will provide counseling to tenants both before and after purchase on the rights and responsibilities of homeownership.

Reading, Pennsylvania

The Reading Housing Authority is proposing a homeownership program for eight scattered site units. The units were rehabilitated in 1969 and are in sound physical condition. A majority of the units are located in a neighborhood where the city and the Neighborhood Housing Services (NHS) are jointly sponsoring a neighborhood revitalization program. This effort will also be a joint venture between the housing authority, the NHS, and the city.

Nashville, Tennessee

The Nashville Metropolitan Development and Housing Authority proposes to convert two kinds of projects to homeownership. The first is the 48 unit Edgefield Annex development which is a multifamily apartment complex. The second is 37 units of scattered site duplex and triplex housing which is currently under construction. Both projects are located in single-family, stable residential neighborhoods which are undergoing some public and private revitalization.

The Housing Authority has set sales prices for both projects based on purchasers' ability to pay. An average minimum annual income of $10,000 will be required and tenants will pay monthly total housing costs which equal 30% of their incomes. Average total monthly expenses are estimated to be $250. Approximately 25% of the current tenants of Edgefield Annex are eligible and interested in purchasing. The scattered site units are under construction and the Housing Authority has a large pool of eligible families from which to make the selection of purchasers. Edgefield Annex and two of the scattered site developments will be set up as cooperatives. The remaining scattered site development will be established as a condominium.

Private financing arrangements are still being worked out. For Edgefield Annex, some minor repairs will be financed through the blanket mortgage. There is an annual set aside of $100,000 of CDBG funds for homeownership activities which will be used to provide interest rate buydown for purchasers. The Housing Authority is also considering issuing bonds to finance the sales. A down payment of $500 will be required.